ST.MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

MASTER OF BUSINESS ADMINISTRATION (MBA)

ASSESMENT OF LIQUIDITY RISK MANAGEMENT ON FINANCIAL PERFORMANCE OF PRIVATE COMMERCIAL BANKS IN ETHIOPIA: SPECIAL FOCUS ON WOGAGEN BANK

BY: MELAKU BELAY GEBREIGZABHER

ADVISOR: TESFAYE TILAHUN (PhD)

DECEMBER, 2024

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UNDER THE GUIDANCE OF TESFAYE TILAHUN (PHD)

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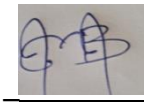
DECLARATION

Melaku Belay Gebreigzabher,I want to declare that this thesis entitled:**"ASSESMENTOF LIQUIDITY RISK MANAGEMENT ON FINANCIAL PERFORMANCE OF PRIVATE COMMERCIAL BANKS IN ETHIOPIA:SPECIAL FOCUS ON WOGAGEN BANK"**, has been carried out by me under the guidance and supervision of **Tesfaye Tilahun (PhD).**This thesis is original and has not been submitted for the award of any degree or diploma to any university or College.



Melaku Belay Gebreigzabher _____ December /2024

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ENDORSEMENT

This thesis has been submitted to St. Mary's University, School of Graduate Studies for Examination with the approval as a university advisor.

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List of Acronyms

CRR- Cash Reserve Ratio

EPRDF- Ethiopian People's Revolutionary Democratic Front

FDI- Foreign Direct Investment

LDR- Loan-to-Deposit Ratio

LACLR- Liquid Assets to Current Liabilities Ratio

LATAR- Liquid Assets to Total Assets Ratio

MBA- Master of Business Administration

NPLR- Non-Performing Loans Ratio

ROA- Return on Assets

ROE- Return on Equity

CPI – Conflict and Political Instability

NBE– National Bank of Ethiopia

Abstract

This thesis investigates the assessment of liquidity risk management and its impact on the financial performance of private commercial banks in Ethiopia, with a special focus on Wegagen Bank, from 2016 to 2023. The study employs a quantitative research approach and explanatory research design, utilizing secondary data from Wegagen Bank's annual financial reports. The analysis centers on key liquidity ratios: Cash Reserve Ratio (CRR), Loan-to-Deposit Ratio (LDR), Liquid Assets to Total Assets Ratio (LATAR), Liquid Assets to Current Liabilities Ratio (LACLR), and Non-Performing Loans Ratio (NPLR), correlating them with financial performance indicators such as Return on Assets (ROA) and Return on Equity (ROE), along with the moderating variable of Conflict and Political Instability (CPI).The findings reveal a significant positive correlation between liquidity management practices and financial performance, indicating that effective liquidity risk management is crucial for maintaining financial stability, particularly in an environment characterized by political unrest. The study highlights that Wegagen Bank's financial performance has been adversely affected by rising non-performing loans and the impact of political instability.Based on these findings, the researcher recommends that Wegagen Bank enhance its liquidity management frameworks, implement robust credit risk management practices, adopt adaptive strategies to respond to political instability, and strengthen stakeholder communication to rebuild trust. Furthermore, it underscores the need for additional empirical research to explore the long-term effects of liquidity strategies under varying political circumstances.

Key Terms:*Liquidity Risk Management, Financial Performance, Political Instability, Private Commercial Bank, Wegagen Bank.*

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The histories of both past and current banking failures highlight the critical role of liquidity in financial institutions. Global financial crises have shown that liquidity is a key factor in a bank's ability to survive. For example, the financial crisis of 2008 led to the downfall of numerous banks, primarily due to excessive lending practices related to subprime mortgages and mismatched durations of assets and liabilities. The banking sector is essential for the economy as it collects deposits and provides loans to various stakeholders, including government entities, households, and businesses (Kirimi, Kithinji, & Gatauwa, 2023). The effectiveness of commercial banks is vital for the overall economic growth and stability of any nation.

Bank performance can be influenced by a myriad of factors, including internal characteristics such as the specific traits of the bank and management decisions, as well as external variables like inflation, interest rates, and political instability (Ongore & Kusa, 2013). Maintaining sufficient liquidity is crucial for the smooth operation of banks, ensuring they can meet their financial commitments. However, achieving the right balance of liquidity is a significant challenge for bank managers, who must reconcile liquidity needs with profitability (Olalekan & Adeyinka, 2013). Holding too many liquid assets can restrict opportunities for more lucrative investments, which ultimately leads to lower profitability. On the other hand, inadequate liquid assets can expose banks to risks of default, potentially resulting in liquidity crises or even bankruptcy.

Risk management has become increasingly important in banking as institutions face various risks that can significantly affect their financial performance and stability. The Basel Committee on Banking Supervision has identified key risks that banks encounter, including credit risk, market risk, operational risk, liquidity risk, and interest rate risk (Basel Committee, 2006). Effective risk management practices are paramount for banks to identify, assess, monitor, and mitigate these risks, thereby safeguarding their assets and ensuring long-term viability.

The financial sector in Africa has faced substantial challenges in recent years, particularly in the realm of liquidity risk management (Berhanu & Kebede, 2020). Private commercial banks in the region operate in a complex landscape often characterized by ongoing conflict and political instability, which adversely impacts their liquidity and overall financial health (Asongu & Nwachukwu, 2016). Existing literature indicates that effective liquidity risk management techniques such as maintaining adequate cash reserves, diversifying funding sources, and implementing robust risk monitoring systems are essential for banks to endure external shocks and maintain financial resilience (Demirgüç-Kunt & Huizinga, 1999).

Ethiopia has experienced significant political upheaval under the Ethiopian People's Revolutionary Democratic Front (EPRDF) for 27 years, facing criticism for undemocratic practices and various forms of social inequity (Mengistu Nega Lakew, 2020). These issues sparked organized public protests beginning in 2016, leading to widespread political, social, and economic unrest. The fundamental role of banks is to convert short-term deposits into long-term loans, making them inherently susceptible to liquidity risk (Eyob Kindu, 2019; Berhanu, 2021).

Given the ongoing political instability in Ethiopia, it is essential to investigate its impact on the profitability of the banking sector. The World Governance Index survey conducted by the World Bank (2016) revealed a continuous decline in the profitability of Ethiopian banks, as measured by Return on Assets (ROA) and Return on Equity (ROE), from 2012 to 2016, raising concerns about the effects of political instability on banking performance. The period from 2016 to 2023 witnessed significant unrest in Ethiopia, especially in the Tigray, Amhara, and Oromia regions, emphasizing the need to evaluate the effects of these conflicts on banking operations. This study examines the assessment of liquidity risk management on the financial performance of Wegagen Bank, specifically exploring the relationship between liquidity risk ratios and financial performance indicators in the context of ongoing conflict and political instability.

1.2 Background of Wegagen Bank

Wegagen Bank S.C. was founded on June 11, 1997, by 16 founding members who acknowledged the vital role of financial institutions in promoting economic growth. The bank was officially registered with the National Bank of Ethiopia on April 30, 1997, with an initial paid-in capital of 30 million Birr. Initially, it operated from its head office in Gofasefer,

Addis Ababa. In October 2017, Wegagen Bank relocated to its new 23-story headquarters situated on Ras Mekonen Street, directly across from the Addis Ababa Stadium.

Over the past 25 years, Wegagen Bank has experienced both achievements and challenges as a first-generation private financial institution. Starting with just two branches, it has expanded to include 5,000 shareholders, with paid-up capital increasing to 34 billion Birr and total assets reaching 41 billion Birr. However, these successes have not been without difficulties; nearly two years ago, the bank faced unfounded rumors that led to significant withdrawals of deposits, compounded by management changes that impacted its position in a competitive financial landscape.

1.3 Statement of the Problem

The Ethiopian banking sector is instrumental in fostering economic growth, making its stability a critical element of the nation's economic health. However, persistent political instability characterized by conflict, violence, and ethnic tensions presents substantial challenges to the sustainability of banking operations. As a developing nation in Africa, Ethiopia has faced numerous obstacles affecting its financial institutions. Recent years have been marked by significant political and social turmoil, including ethnic violence, widespread protests, economic fluctuations, and shifts in government leadership. These dynamics have notably altered the economic landscape and have had particularly strong effects on the banking industry (Abate, M. 2021).

The specific impact of the unique political and security issues in Ethiopia, particularly the conflict in the Tigray region that escalated in November 2020, on private commercial banks like Wegagen Bank remains insufficiently explored. This gap in the existing literature is significant, as Wegagen Bank has shown increased vulnerability during this challenging period (Kasa, M. 2022). Liquidity risk management has become a critical concern for private banks in Ethiopia, particularly given the ongoing political and economic instability. Effective management of liquidity risk is essential for these institutions to maintain financial stability, meet short-term obligations, and ensure long-term viability.

This research is timely and relevant, considering the broader economic and political challenges Ethiopia is currently experiencing. The profitability of the banking sector has recently declined, partly due to the effects of conflict and instability, as highlighted by the

World Governance Index survey conducted by the World Bank (2016). Therefore, this study aims to fill a significant gap in the literature regarding the interactions among political risk, liquidity management, and financial performance within the Ethiopian context. The anticipated findings will offer practical insights for the management and regulation of private commercial banks in Ethiopia by elucidating how political instability influences liquidity risk and financial performance. This study could contribute to the development of more effective risk management frameworks and policies, ultimately enhancing the resilience of the Ethiopian banking sector.

This research will specifically analyze the impact of liquidity risk management on the financial performance of Wegagen Bank from 2016 to 2023. This timeframe is particularly critical as it encompasses recent political and social upheavals, notably the significant conflict in the Tigray region. The conflict, which commenced in November 2020, has profoundly affected the banking sector. This study will examine how Wegagen Bank's liquidity risk management strategies such as asset-liability management, liquidity ratio monitoring, and contingency planning have impacted its financial performance and resilience during this civil unrest.

An in-depth case study of Wegagen Bank will reveal the specific challenges the institution faced in maintaining adequate liquidity levels and managing liquidity risks amid the disruptions caused by the conflict with the TPLF and the federal government. Although the Pretoria Agreement provided a temporary respite, recent political developments, including the closed-session election on August 14, 2024, have raised concerns about the potential resurgence of instability and its implications for the Tigray region and beyond. The conflict's expansion into other areas, such as Amhara, Oromia, and Benishangul, has intensified the liquidity challenges confronting banks, posing significant risks to the country's economy.

Previous studies examining the relationship between liquidity risk management and financial performance in Ethiopia have yielded inconsistent results (Tadesse, K. 2020). For instance, while some research (e.g., Berhanu Legesse, 2021) indicates a positive correlation, others (e.g., Eyob Kindu, 2019; Endaweke Mitku, 2015) report negative associations. Additionally, findings from Mengistu Nega Lakew (2020) suggest that political instability positively impacts bank profitability. However, many of these studies have concentrated on the broader banking sector or state-owned banks, often neglecting the unique challenges that private entities like Wegagen Bank face amid political and social unrest.

Existing literature on the relationship between liquidity risk management and financial performance in the Ethiopian banking sector has produced mixed results. Some studies indicate a positive relationship, while others highlight negative correlations. This research aims to clarify the complex interactions among political instability, liquidity risk management, and the financial performance of Wegagen Bank, contributing to a deeper understanding of the challenges currently facing the Ethiopian banking sector.

1.4 Research Hypothesis

To fulfill the objectives of the study, the following research hypothesis were formulated:

H1: There is a significant **positive** relationship between the Cash Reserve Ratio (CRR) and (ROA and ROE) of Wegagen Bank.

H2: The Loan-to-Deposit Ratio (LDR) has a significant **positive** effect on (ROA and ROE) of Wegagen Bank.

H3: There is a significant **positive** relationship between the Liquid Assets to Total Assets Ratio (LATAR) and (ROA and ROE) of Wegagen Bank.

H4: The Liquid Assets to Current Liabilities Ratio (LACLR) has a significant **positive** impact on(ROA and ROE) of Wegagen Bank.

H5: Non-Performing Loans (NPLs) have a significant **negative** influence on the (ROA and ROE) of Wegagen Bank, particularly in the context of political instability.

H6: Conflict and political instability **negatively** affect liquidity risk management, which in turn has a significant adverse impact on the financial performance of Wegagen Bank from 2016 to 2023.

1.5 Objectives of the Study

1.5.1 General Objective

The main goal of this research was to examine the assessment of liquidity risk management on the financial performance of Wegagen Bank in the context of conflict and political instability in Ethiopia from 2016 to 2023.

1.5.2 Specific Objectives

1. To assess the Cash Reserve Ratio (CRR) on the financial performance of Wegagen Bank, as indicated by Return on Assets (ROA) and Return on Equity (ROE).
2. To analyze the effect of the Loan-to-Deposit Ratio (LDR) on the financial performance of Wegagen Bank, focusing on ROA and ROE.
3. To evaluate the relationship between the Liquid Assets to Total Assets Ratio (LATAR) and the financial performance metrics ROA and ROE of Wegagen Bank.
4. To explore how the Liquid Assets to Current Liabilities Ratio (LACLR) has affected the financial performance of Wegagen Bank.
5. To investigate the influence of Non-Performing Loans (NPLs) on the financial performance of Wegagen Bank, particularly in the context of political instability.
6. To examine the overall effects of conflict and political instability on liquidity risk management and its subsequent influence on the financial performance of Wegagen Bank from 2016 to 2023.

1.6 Significance of the Study

This study aims to provide valuable insights for Wegagen Bank and other private commercial banks in Ethiopia, helping them enhance their liquidity risk management strategies and improve financial performance. Additionally, the findings will contribute to the limited empirical research on the relationship between liquidity risk management, bank performance, and the effects of conflict and political instability in the Ethiopian private banking sector. Ultimately, this research seeks to support the achievement of a Master of Arts degree in Business Administration.

1.7 Delimitation of the Study

The study concentrated on the assessment of liquidity risk management on financial performance within the context of conflict and political instability in Ethiopia, specifically focusing on Wegagen Bank from 2016 to 2023. It analyzed bank-specific liquidity management variables, including the Cash Reserve Ratio (CRR), Loan-to-Deposit Ratio (LDR), Liquid Assets to Total Assets Ratio (LATAR), Liquid Assets to Current Liabilities Ratio (LACLR), and Non-Performing Loans Ratio (NPLR). The performance measures were defined by ROA and ROE, with particular attention to the moderating variable of Conflict

and Political Instability (CPI). The case study was centered on Wegagen Bank's head office in Addis Ababa Ethiopia, how conflicts and political instability in Ethiopia especially the northern Ethiopian conflictaffects the financial performance of Wegagen bank,while excluding other different private and public banks in Ethiopia. Additionally, the research did not encompass other bank-specific factors or external variables such as macroeconomic indicators like GDP and inflation.

1.8 Limitation of the Study

Given the ongoing civil conflict in Ethiopia, other private or public banks may have faced similar issues. The decision to exclude them may limit the comprehensiveness of the research, especially considering the ethnic and regional dynamics of banking in Ethiopia. For instance, banks such as Lion International Bank, which encountered significant challenges during the Tigray conflict, could have provided deeper insights into the vulnerabilities within the Ethiopian banking system.

1.9 Organization of the Study

This paper is organized into five chapters. Chapter One**:** Background, statement of the problem, specific research questions, objectives of the study, significance, delimitations, limitations, and organization of the study.Chapter Two**:** Review of related literature, including theoretical and empirical reviews and conceptual frameworks.Chapter Three**:** Methodology covering research approach, design, types and sources of data, sample size, sampling techniques, and methods of data analysis.Chapter Four**:** Response rates, demographic characteristics, descriptive analysis, correlation analysis, regression analysis, regression assumptions, inferential analysis, and summary of actual and expected signs of explanatory variables on the dependent variables ROA and ROE.Chapter Five**:** Summary, conclusions, and recommendations based on the study's findings.

CHAPTER TWO

REVIEW RELATED LITRATURE

This chapter focused on reviewing literature related to liquidity risk in the banking system and its influence on performance. The literature review was organized as follows: The first section presented a theoretical review, covering concepts of liquidity, theories of bank liquidity management, and risks in providing banking services, banking liquidity risk management, organizational performance measurement, and the impact of political instability on banking. The second section discussed empirical studies at the global level, within Africa, and specifically in Ethiopia, addressing the identified research gaps. The third section reviewed the conceptual framework of the study**.**

2.1 Theoretical Literature Review

2.1.1 Concepts of Liquidity

Kimberly (2016) defined liquidity as the amount of money readily available for investment and spending. The concept raised concerns for management due to uncertainties about future liquidity. Essentially, liquidity referred to the capital available for investment at the time, much of which came from credit rather than cash. Large financial institutions preferred borrowed money, and high liquidity indicated an abundance of capital, particularly in low-interest-rate environments. Vita (2017) noted that adequate liquidity allowed banks to meet depositors' withdrawal demands and borrowers' cash needs without significant loss.

Amengor (2010) emphasized that liquidity represented a bank's ability to finance its contractual obligations, including lending, investment, and customer withdrawals. Olanrewaju (2011) defined liquidity as the state of a business that determines its capacity to meet maturing obligations, which consisted of current liabilities and long-term debts. Moreover, liquidity served as a measure of assets that could be quickly converted into cash without loss in value, ensuring that short-term liabilities could be met.

In summary, increasing liquidity reduced the likelihood of technical insolvency. Definitions of liquidity also recognized two dimensions: the time needed to convert assets into cash and the certainty associated with the conversion's value. Marozva (2015) categorized bank liquidity into market liquidity and funding liquidity, where the former pertained to how easily a bank's securities could be traded, and the latter related to a bank's ability to secure funding.

2.1.2 Theory of Bank Liquidity Management

The primary goal of a commercial bank was to generate liquidity while maintaining financial stability. Various theories informed the management of liquidity risk, focusing on asset and liability management. For this study, the relevant theories included Commercial Loan Theory, Shift ability Theory, Anticipated Income Theory, and Liability Management Theory.

2.1.2.1 Commercial Loan Theory

According to Machiraju (2003), Commercial Loan Theory posited that a bank's liquidity was assured as long as assets were held in short-term loans that were liquidated in the normal course of business. However, Botoe (2011) argued that this theory was flawed as it did not account for the credit needs of the economy or the stability of core deposits, which were essential for extending loans without risking illiquidity.

2.1.2.2 Shift ability Theory

Mitchell (1923) described Shift ability Theory, which asserted that banks should maintain the capacity to meet depositor demands by offering short-term loans for commercial purposes. This theory faced criticism for several reasons, including the lack of liquidity at maturity and the challenges posed by reliance on short-term commercial paper. Machiraju (2003) explained that banks could protect themselves against deposit withdrawals by holding liquid reserves, such as treasury bills, which met marketability criteria.

2.1.2.3 Anticipated Income Theory

The Anticipated Income Theory suggested that liquidity could be ensured through scheduled loan payments based on the future income of borrowers. This theory emphasized the relationship between loan repayment and borrower income rather than collateral. Machiraju (2003) and Botoe (2011) noted that this approach allowed banks to accommodate credit demands effectively, adapting repayment schedules to anticipated income.

2.1.2.4 Liability Management Theory

Machiraju (2003) stated that Liability Management Theory posited that banks could meet liquidity requirements by bidding in the market for additional funds to satisfy loan demand and deposit withdrawals. This approach became significant after the federal funds market's revitalization in the 1950s.

2.1.3 Risks in Providing Banking Services

Commercial banks faced various risks associated with their financial services, which could be categorized into six generic types: systematic or market risk, credit risk, counterparty risk, liquidity risk, operational risk, and legal risk. This study primarily focused on credit risk, and liquidity risk.

2.1.3.1 Credit Risk

Credit risk arose when borrowers defaulted on their loans, failing to repay either the principal or interest. A delay in loan repayment constituted credit risk, leading to potential losses for banks. Credit risk could be classified into transaction risk and portfolio concentration risk, where the latter referred to the concentration of loans in specific sectors or areas. Greuning and Bratanovic (2009) highlighted that credit risk was a principal cause of bank failures.

2.1.3.2 Liquidity Risk

Liquidity risk was the possibility that a bank would be unable to meet its obligations promptly. Drehmann and Nikolaou (2009) defined it as the risk arising from a bank's inability to meet obligations without incurring unacceptable losses. This risk could significantly impact a bank's earnings and capital, making it a top priority for management to ensure sufficient funds were readily available.

2.1.3.3 Operational Risk

Operational risk stemmed from potential failures in internal processes, systems, or controls that could lead to unexpected losses. The growing reliance on technology in banking underscored the importance of identifying and managing this risk. As defined by Crouhy et al. (2006), operational risk encompassed losses from inadequate systems, management failures, and human error.

2.1.4 Bank Liquidity Risk Management

The significance of liquidity in sound banking practices was well established at both theoretical and operational levels. Bank liquidity reflected the extent to which a financial institution could meet its obligations under normal business conditions. Dziobek, Hobbs, and Marston (2000) argued that bank liquidity was closely linked to confidence, as its primary role was to assure both the bank and its customers that the bank could fulfill its liabilities as they came due without needing to roll them over or postpone credit access. Consequently, a

key objective of liquidity risk management was to implement confidence-enhancing practices (Bundesbank, 1982).

Liquidity risk primarily arose from a flawed balance sheet structure concerning the bank's assets and liabilities, which could hinder the bank's ability to provide cash for unexpected events. Excessive liquidity issues often indicated deeper underlying problems, frequently preceded by high levels of risk taken by the bank, such as interest rate risks, mismatched asset and liability maturities, or credit risks from non-performing loans.

Effective liquidity management in commercial banks required holding sufficient liquid assets to meet normal operational needs, including reserve requirements, while minimizing excess balances (Dziobek et al., 2000). These authors emphasized that both asset liquidity and liability management were central to liquidity risk management. Asset liquidity could be enhanced by maintaining liquid assets, managing the maturity distribution of non-liquid assets to align with liquidity needs, or selling or lending collateralized claims. Liability management focused on controlling liquidity risk by minimizing the volatility between assets and liabilities and ensuring access to funding markets.

Techniques to limit liquidity mismatches included extending the maturity of liabilities and increasing stable core deposits. Additionally, banks could improve funding market access by diversifying funding sources across various market segments, thereby reducing vulnerability to market disruptions and enhancing the likelihood of retaining or replacing funding during crises. Banks often established contingency arrangements and maintained bilateral or last-resort agreements for temporary fund access (Dacey&Bazel-Horowitz, 1990).

One significant challenge related to liquidity risk was the need for funding during sudden crises. This required analyzing funding demands under various worst-case scenarios, which could include bank-specific shocks, such as severe losses, and system-wide crises. In each situation, banks assessed their self-supporting capabilities during a crisis and estimated how quickly such shocks could lead to funding crises (Santomero, 1997).

2.1.5 Organizational Performance Measurement

Performance measurement and its indicators were described by various scholars. Rahel (2014) noted that performance measurement involved periodic assessments of progress toward both long-term and short-term goals, providing outcomes to decision-makers to enhance program performance. According to Robert B. Carton (2004, cited in Rahel, 2014),

performance measurement criteria could be categorized into five sections: accounting measures, operational measures, market-based measures, survival measures, and economic value measures.

2.1.5.1 Accounting Measures

As indicated by Eyob (2010), financial performance measures reflected an organization's economic targets, focusing on profitability and operational cost reduction. Key financial performance indicators included profitability and cost ratios, such as return on assets (ROA), return on investment (ROI), return on sales (ROS), total operating expenses to sales (OEXPS), and general and administrative expenses to sales (GAS).

2.1.5.2 Operational Measures

Operational measures assessed how effectively an organization addressed non-financial issues. The importance of measuring performance in non-financial dimensions grew in recent years, particularly with the adoption of balanced scorecard approaches for integrating strategy and performance measurement (Rahel, 2014). These measures included changes in market share, intangible assets like patents or human resource skills, and customer satisfaction. By applying both accounting and operational measures, organizations could evaluate both qualitative and quantitative aspects of their operations.

2.1.6 Political Instability and Banking

Research extensively examined the detrimental effects of political instability on banking sectors worldwide. For instance, Bittencourt (2012) highlighted that political turmoil could lead to significant operational disruptions within banks. Increased transaction costs and operational risks could hinder banks from effectively serving customers, especially during civil unrest or governmental changes that might result in branch closures and reduced customer interactions.Moreover, banks' financial performance tended to decline in politically unstable environments. Demirgüç-Kunt and Detragiache (2005) found that banks in high political risk countries experienced lower profitability due to increased operational costs and diminished customer trust. This decline in profitability was often coupled with a rise in non-performing loans, as borrowers struggled to meet obligations in uncertain economic conditions (Laeven& Valencia, 2013).

Political instability also influenced investor behavior. Research indicated that foreign direct investment (FDI) in the banking sector diminished in politically volatile regions, leading to reduced capital inflows and hampering banks' ability to expand and innovate (Jensen, 2008).

Furthermore, stock market reactions to political events revealed that banks' stock prices were sensitive to political risk, reflecting investor concerns regarding future profitability and stability (Bae et al., 2006).

In Ethiopia, the banking sector faced challenges related to regulatory changes driven by political shifts. Regulatory uncertainty could lead to increased risk aversion among banks, resulting in tighter lending practices and reduced credit availability for consumers and businesses (Khan & Raza, 2018). This tightening of credit could stifle economic growth and exacerbate the challenges faced by the banking sector. The impact of political instability on banking became increasingly relevant due to recent political changes and unrest. Tadesse (2020) examined the challenges faced by Ethiopian banks during political turmoil, noting that liquidity issues and operational risks escalated. The study highlighted that banks such as Wegagen Bank struggled to maintain customer confidence and manage liquidity during such unrest.

2.2 Empirical Review

Liquidity risk refers to the potential that a bank may become unable to meet its obligations in a timely manner (Halling & Hayden, 2006). The susceptibility of banks to liquidity risk is influenced by both funding and market risks (Gorton & Winton, 2000). Funding liquidity risk arises from discrepancies between cash inflows and outflows or unexpected liquidity demands, whereas market liquidity risk involves the inability to sell assets at or close to their fair value, which may lead to price declines in smaller markets (Hassan, 2009).

2.2.1 Global Perspectives

Research on bank-specific factors affecting liquidity in English banks by (Halling and Hayden, 2006) revealed that liquidity ratios are influenced by variables such as bank profitability and loan growth which exhibit a negative correlation with liquidity. The liquidity generated by Germany’s state-owned savings banks and its determinants was explored by Hassan et al. (2009), who analyzed 457 state-owned savings banks from 1997 to 2006 and assessing the impact of monetary policy on liquidity creation.

Key determinants included monetary policy interest rates unemployment rates and savings rates, with findings indicating that stricter monetary policies diminished bank liquidity. Bordeleau and Graham (2010) pointed out that a bank’s profitability is affected by its dependence on short-term funding, while Alshatti (2015) observed a positive relationship between liquidity ratios and the profitability of Jordanian banks.

2.2.2 African Context

Numerous studies within the African context examined the interplay between liquidity and bank profitability. Siaw (2013) studied Ghanaian banks, found a positive link between exposure to liquidity risk and profitability, suggesting that banks with higher liquidity risk might gain from net interest margins. Nyaga (2014) provided evidence from Ukrainian firms indicating a positive association between liquidity ratios and profitability, while Ibe (2013) noted that poor liquidity management negatively affected performance in Nigerian banks.

2.2.3 Ethiopian Local Studies

Effective liquidity risk management is crucial for the financial stability and performance of banks, especially in volatile environments. Proper liquidity management practices can significantly enhance a bank's financial performance by ensuring sufficient cash flows to meet obligations (Alshahrani & Sadiq, 2020). In Ethiopia, where liquidity constraints are often intensified by economic fluctuations and regulatory challenges, effective liquidity management is vital. Research indicates that banks that prioritize liquidity management are better equipped to handle financial distress and maintain operational efficiency (Naceur & Omran, 2011).

Studies focused on the Ethiopian banking sector revealed that banks with strong liquidity management practices tend to perform better financially even in challenging conditions. Effective liquidity risk management can alleviate some negative effects of political instability, enabling banks to sustain profitability through strategic asset management (Endawek Mitku, 2015).

The study titled "Risk Management and Its Impact on Financial Performance of Commercial Banks in Ethiopia" explored the relationship between risk management practices and bank performance from 2002 to 2013, finding that credit and liquidity risk management adversely affected performance while capital adequacy showed a positive but statistically insignificant relationship. This indicates a need for additional empirical studies to comprehensively analyze these dynamics (Sirak Yifru 2016).

Research from 2010 to 2015 on the effects of liquidity risk on the financial performance of NIB International Bank indicated a positive correlation between liquidity and financial performance. However, it also revealed that excessive liquidity could lead to diminished profitability prompting further investigation into liquidity management strategies in Ethiopian banks (Tsige, 2017).

Eyob (2019) examined the impact of liquidity on the performance of commercial banks in Ethiopia from 2011 to 2018, concluding that maintaining optimal liquidity levels significantly enhances bank performance. This finding highlights the research gap regarding specific liquidity measures affecting performance in the Ethiopian banking sector, which has not been thoroughly investigated in earlier studies.

Yared Kassa (2021) studied the effect of liquidity management on the performance of commercial banks in Ethiopia from 2000 to 2018, discovering a positive correlation between capital adequacy and financial performance. Effective liquidity management was found to enhance profitability indicating a need for further exploration of bank-specific factors influencing performance.

Ariam Tesfazgi (2021) examined contemporary practices within Ethiopian commercial banks linking effective risk management practices to improved bank performance and found that enhanced risk management significantly contributed to overall performance.

Alemu Ademe (2023) investigated the impacts of political instability on Ethiopian banks from 2013 to 2021, identifying key variables influencing performance, such as political violence, inflation and liquidity findings indicated that political violence and inflation negatively affected both ROA and ROE, while deposit volumes and operational efficiency had positive effects.

2.2.4 Impact of Political Instability on Financial Performance

The Ethiopian banking sector has faced significant challenges due to ongoing conflicts and political instability studies have shown that political instability adversely affects banking performance by increasing perceived risks among investors and depositors (Beck et al., 2013). In unstable environments, banks experienced higher withdrawal rates leading to liquidity shortages that hinderoperational capability.

Political instability, marked by governance uncertainty and potential civil unrest has profound implications for the banking sector. Chawdhury (2015) noted that political instability negatively impacts investment levels and economic growth subsequently affecting bank profitability. Since 2016, political upheaval has led to increased liquidity risk as banks encounter higher withdrawal rates and diminished customer confidence conflicts often exacerbate liquidity challenges with research by Mbaku (2016) indicating increased risks of capital flight and elevated operational costs in conflict-affected regions.

The situation of Wegagen bank during this period illustrates broader trends as the institution navigated the ramifications of political unrest while striving to maintain liquidity. Empirical studies focusing on Ethiopian banks emphasized the critical role of liquidity risk management during conflicts. For instance Mulu (2020) found that banks with effective liquidity management practices were more resilient during political unrest demonstrating lower volatility in financial performance metrics such as ROA and ROE.

Furthermore, conflicts could disrupt service delivery and the overall banking infrastructure, negatively impacting customer trust and financial performance (Khan & Raza, 2021) these dynamics necessitated the establishment of robust liquidity risk management frameworks to mitigate the adverse effects of political turmoil. Research by Demissie (2022) indicated that banks employing proactive liquidity strategies could maintain customer confidence and attract deposits even amid instability. These findings underscored the importance of liquidity risk management not only as a financial instrument but also as a strategic necessity for survival in politically volatile environments.

2.2.5 Research Gap

The identified research gap in examining liquidity risk management and its influence on the financial performance of private commercial banks in Ethiopia particularly Wegagen bank from 2016 to 2023 highlighted several key issues existing studies predominantly focused on developed countries limiting their applicability to Ethiopia's unique socio-political context where instability significantly impacts banking operations.

Current literature presents conflicting findings regarding the relationship between liquidity risk and bank performance. Some studies indicate negative impacts of liquidity risk management on performance, while others suggest positive correlations. This inconsistency underscores the necessity for empirical research that considers a broader range of factors including regulatory influences and macroeconomic conditions alongside bank-specific variables. There is an urgent need for comprehensive studies to clarify how liquidity risk management strategies interact with financial performance in Ethiopian banks, particularly under conditions of conflict and political instability.

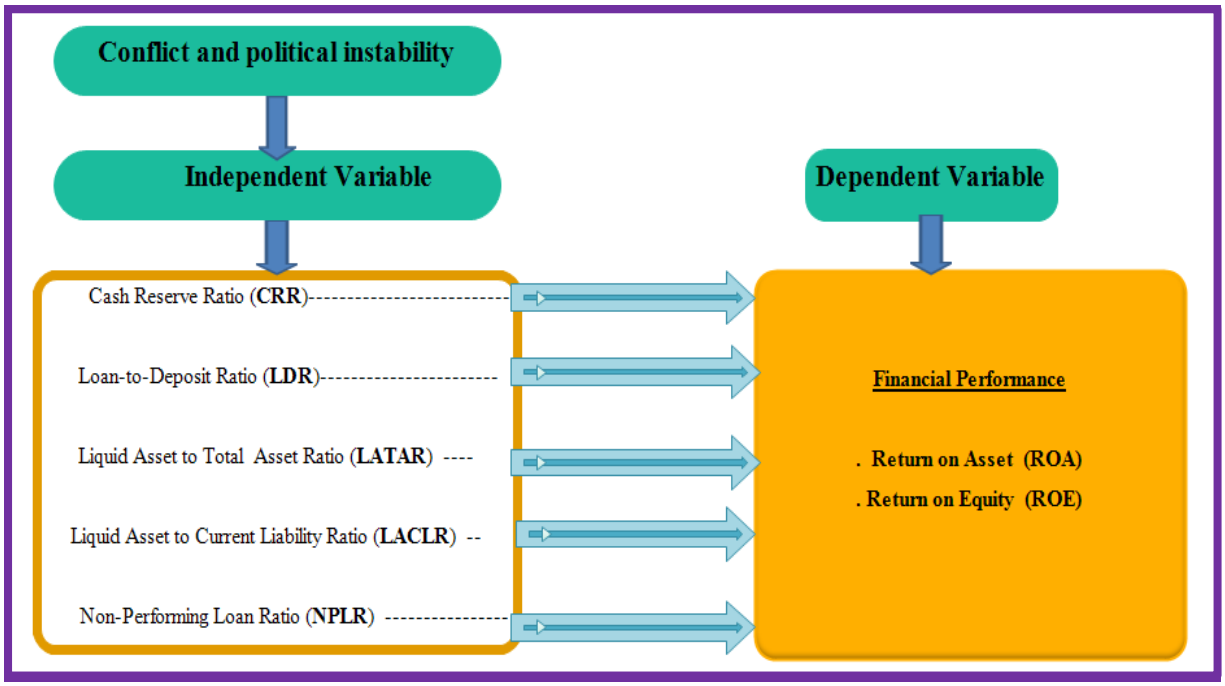
2.3 Conceptual Framework

The conceptual framework illustrates the interactions among the dependent variable independent variables and the predominant influences of conflict and political instability. The

dependent variable, financial performance, is assessed through key indicators such as return on assets ROA and return on equity ROE.

The independent variables include liquidity risk ratios such as the cash reserve ratio (CRR) loan-to-deposit ratio (LDR) liquid assets to total assets ratio (LATAR) liquid assets to current liabilities ratio (LACLR) and non-performing loans Ratio (NPLR). This framework is designed to elucidate the effects of liquidity risk management on the financial performance of wegagen bank a private commercial bank in Ethiopia. The interaction among these elements aims to provide a comprehensive understanding of how liquidity risk, influenced by political and social factors affects the banks financial performance.

Figure1: Conceptual Framework



Source: Researcher Own Development based on related Literature Review Alemu Ademe, (2023); Yared Kassa, (2021).

CHAPTER THREE

METHODOLOGY OF THE STUDY

This chapter outlined the research design and methodology used to investigate the assessment of liquidity risk management on the financial performance of Wegagen Bank, a private commercial bank in Ethiopia, from 2016 to 2023. The sections included are research approach, data collection, population and sample size, sampling techniques, data analysis, validity and reliability, variable descriptions, model specifications, and ethical considerations.

3.1 Research Design:

This study utilized an explanatory research design to investigate the relationships between liquidity risk indicators and bank performance metrics, enabling the statistical analysis of numerical data. This approach, as highlighted by Creswell (2014), facilitates the identification of patterns and connections among variables, providing a structured framework that ensures the research objectives are met. Additionally, a well-defined research design is essential for systematic data collection and analysis, serving as a roadmap for researchers (Jenkins-Smith et al., 2017; McCombes, 2019). Such a structured methodology enhances the validity and reliability of the study's findings.

The research utilized secondary source of datawhich isannual financial reports of Wegagen Bank. The time series or longitudinal data from 2016 to 2023 enabled a comprehensive analysis of the interplay between political instability, liquidity management practices, and financial performance.

3.2 Research Approach:

According to Creswell (2009), research approaches can be categorized as quantitative, qualitative, or mixed. This study employed a quantitative approach, focusing on determining the relationship between independent variables (liquidity ratios) and dependent variables (bank performance). The quantitative methods included annual reports from Wegagen Bank, allowing for the quantification of data relevant to liquidity management and its effects on financial performance.

The research followed quantitative approach, starting with the hypothesis that effective liquidity risk management positively influenced the financial performance of Wegagen Bank, particularly in contexts of political instability (Bryman & Bell, 2015). The hypothesis posits that Non Performing Loan Ratio and conflict and political instability negatively influence the financial performance of Wegagen Bank, a private commercial bank in Ethiopia. This hypothesis is grounded in the understanding that political turmoil can lead to increased uncertainty, which adversely affects banking operations.

3.3 Data Collection

Data collection focused on several liquidity ratios as independent variables, including: Cash Reserve Ratio (CRR), Loan-to-Deposit Ratio (LDR), Liquid Assets to Total Assets Ratio (LATAR), Liquid Assets to Current Liabilities Ratio (LACLR), Non-Performing Loans (NPLs) and the dependent variables representing bank performance indicators were Return on Assets (ROA) and Return on Equity (ROE). Additionally, data on the moderating variables of conflict and political instability were collected to assess their impact on liquidity management and financial performance (Khan, 2017).

3.4 Population, Sample Size, and Sampling Techniques

The study's population includes all banks that are presently offering financial services and are registered with the National Bank of Ethiopiauntil June30.2023. Out of the 31 total banks, 29 are private and two are public. This study aims at examining a sample population of only Wegagen Bank Private commercial bank in Ethiopia.

Table 1 Total population

Total population. Bank Name		**Year Est.**
1	Development Bank of Ethiopia	1901
2	Commercial Bank of Ethiopia	1963
3	Awash International Bank	1994
4	Dashen Bank	1995
5	Bank of Abyssinia	1996
6	Wegagen Bank	1997
7	Hibret Bank	1998
8	Nib International Bank	1999
9	Cooperative Bank of Oromia	2005
10	Lion International Bank	2006

11	Oromia International Bank	2008
12	Bunna Bank	2009
13	Zemen Bank	2009
14	Abay Bank S.C	2010
15	Berhan Bank	2010
16	Addis international bank S.c	2011
17	Debub Global Bank	2012
18	Enat Bank	2013
19	ZamZam Bank	2021
20	Hijra Bank	2021
21	Siinqee Bank	2021
22	Shabelle Bank	2021
23	GohBetoch Bank SC	2021
24	Tsehay Bank	2022
25	Amhara Bank	2022
26	Ahadu bank	2022
27	Tsedey Bank	2022
28	Omo bank	2022
29	Geda bank	2022
30	Rammis bank	2022
31	Sidama bank	2022

Source: www.nbe.gov.et

3.4.1 Sample Size

The highly vulnerable in northern Ethiopian conflict Wegagen Bankwas chosen using a non-probability sampling method, considering the Wegagen bank's operations with the conflict and unrest in Ethiopia from 2016 to 2023. The researcher selectedfor this timeframe to collect up-to-date data that could adequately address the research objective, given the apparent shortage of studies analyzing CRR, LDR, LATAR, LACLR and NPLs with moderate variable conflict and political unrest using recent financial data. The selection of one of Ethiopia's leading private commercial bank that is WegagenBankfrom the total population, in accordance with the employed sampling approach, relied on criteria such as vulnerability and data availability.

Sample design deals with sample frame, sample size and sampling a technique of selecting a suitable sample for the purpose of determining parameters of the whole population. Population is the list of elements from which the sample may be drawn, thus, the study obtained Wegagen Bank's publication reports in their audited financial report of 2016 to 2023.

3.4.2 Sampling Techniques

Data that related to annual revenue, profitability and other variables were also collected from their annual financial publication reports and NBE that was related to the study. Sampling is the process of obtaining information about an entire population by examining part of it. For this study the non-probability sampling method specifically, Purposive sampling technique was used. The reason to select purposive sampling incorporated that highly vulnerable banks especially Wegagen bank.

3.5 Data Collection Methods

Primary data were collected through surveys to gain insights into liquidity management practices and their effects on financial performance. Structured questionnaires were administered to Wegagen Bank's top level management involved in risk management, finance management and board members. Secondary data were sourced from Wegagen Bank's annual financial reports and regulatory reports from the NBE regarding liquidity requirements and banking performance.

3.6 Data Analysis Methods

The data analysis in this study employed purely quantitative methods, utilizing both descriptive and inferential statistics to explore the relationship between liquidity ratios and the financial performance of Wegagen Bank. Five independent variables were analyzed: Cash Reserve Ratio (CRR), Loan-to-Deposit Ratio (LDR), Liquid Assets to Total Assets Ratio (LATAR), Liquid Asset to Current Liability Ratio (LACLR), and Non-Performing Loans (NPLs). These liquidity ratios were assessed alongside two dependent variables Return on Assets (ROA) and Return on Equity (ROE) which serve as key indicators of the bank's performance. The analysis utilized statistical software such as SPSS version 26to conduct various statistical techniques, including correlation analysis and Linear Regression.

In addition to examining the direct relationships between liquidity ratios and bank performance, the study also incorporated conflict and political instability as moderating

variables to understand their effects on the financial outcomes. By analyzing data from 2016 to 2023, this research aimed to identify correlations between liquidity risk management and performance indicators, particularly in the context of Ethiopia's ongoing political challenges. Descriptive statistics summarized the data, while inferential statistics helped establish patterns and potential causal relationships. This approach provided a comprehensive understanding of how liquidity levels and the moderating effects of conflict and instability influenced Wegagen Bank's profitability and overall financial health, offering valuable insights into the dynamics of the banking sector under adverse conditions.

3.6.1 Descriptive Statistics

Descriptive statistics encompass a variety of methods used to organize and summarize data (Trochim, 2021). In this study, the following measures were employed: central tendency (mean), dispersion (standard deviation), and the identification of minimum and maximum values (Bluman, 2018). Additionally, the data was organized and presented in tabular form, drawing on secondary data from balance sheets and income statements of financial reports. This approach enhances ease of reference and improves communication of the findings (Smith & Jones, 2020).

3.6.2 Inferential Statistics

Inferential statistics involve methods used to draw conclusions from sample data regarding a larger population (Field, 2018). In this study, only correlation analyses were employed to assess both the nature and strength of the relationship between two variables (Hinton et al., 2014). Correlation analysis is typically conducted alongside regression analysis to evaluate how effectively the regression line accounts for the variation in the dependent variable (Hair et al., 2019). In this study the correlation conducted alongside the assessment of liquidity ratio analysis.

3.7 Validity and Reliability

To ensure the validity and reliability of the findings, established financial ratios and recognized economic indicators were used. Consistency checks were conducted on the data collection methods and statistical analyses, with cross-verification from multiple sources to enhance reliability (Golafshani, 2003).

The analysis of secondary data collected from the annual reports of Wegagen Bank demonstrated high construct and content validity, effectively capturing essential liquidity

ratios and their relationship to financial performance indicators. This secondary data not only validated the findings but also ensured comprehensive coverage of relevant metrics within the banking sector, thereby enhancing the robustness of the study's conclusions.

3.8 Variable Description and Model Specification

For this study on the assessment of liquidity risk management and its impact on the financial performance of Wegagen Bank, a suitable model is the Multiple Linear Regression Model**.** This model allows you to analyze the relationship between multiple independent variables (liquidity ratios) and dependent variables (financial performance metrics like Return on Assets (ROA) and Return on Equity (ROE).

Multiple Linear Regression (MLR) is a statistical technique used to model the relationship between one dependent variable and two or more independent variables. This model is particularly useful in understanding how the independent variables collectively influence the dependent variable (Field, 2013).

The study analyzed the assessment of liquidity risk management and conflict and political instability on the financial performance of Wegagen Bank using two regression models as described in the following equation below.

The general formula for a Multiple Linear Regression Model can be expressed as follows:

$$Yit=\beta0+\beta1X1it+\beta2X2it+\beta3X3it+\ldots+\beta nXnit+\epsilon it$$

For ROA:

$$ROAit=\beta0+\beta1(CRRit)+\beta2(LDRit)+\beta3(LATARit)+\beta4(LACLRit)+\beta5(NPLRit)+\beta6(CPIit)+\epsilon it$$

For ROE:

$$ROEit=\beta0+\beta1(CRRit)+\beta2(LDRit)+\beta3(LATARit)+\beta4(LACLRit)+\beta5(NPLRit)+\beta6(CPIit)+\epsilon it$$

Where:

ROAit = Return on Assets for bank i at time t

ROEit = Return on Equity for bank i at time t

CRRit = Cash Reserve Ratio for bank i at time t

LDRit = Loan-to-Deposit Ratio for bank i at time t

LATARit = Liquid Assets to Total Assets Ratio for bank i at time t

LACLRit = Liquid Assets to Current Liabilities Ratio for bank i at time t

NPLRit = Non-Performing Loans Ratio for bank i at time t

CPIit = Conflict and Political Instability for bank i at time t

β0 = Intercept (constant term)

β1, β2, β3, β4, β5, β6 = Coefficients for each independent variable

єit = Error term (represents all other factors affecting ROA and ROE)

Conflict and Political Instability captured the effects of external factors.

3.8.1 Dependent Variables

a. Return on Asset (ROA)

Return on Assets (ROA) is a financial ratio that measures a bank's profitability relative to its total assets, calculated by dividing net income by total assets. It reflects the efficiency of management in utilizing assets to generate earnings. A higher ROA indicates effective asset management and strong profitability, making it a key metric monitored by the National Bank of Ethiopia (NBE) to assess the financial health of banks.

$$ROA = \frac{\text{Net Income}}{\text{Total Assets}} * 100$$

b. Return on Asset (ROE)

Return on Equity (ROE) assesses a bank's profitability concerning shareholders' equity, calculated by dividing net income by shareholders' equity. This ratio indicates how well a bank generates profit using shareholders' investments. A higher ROE signifies strong

profitability and the bank's capacity to provide returns to shareholders, which is also closely monitored by the NBE.

$$ROE = \frac{\text{Net Income}}{\text{Shareholders' Equity}} * 100$$

3.8.2 Independent Variables

a. Cash Reserve Ratio (CRR)

CRRit = Cash reserve Ratio of Bank i at time t,the proxy is percentage of cash required to be kept in reserve, The Cash Reserve Ratio (CRR) is the percentage of a bank's total deposits required to be held as liquid cash reserves with the central bank. It serves as a regulatory measure to ensure liquidity and stability within the banking system. A higher CRR limits available funds for lending, impacting economic growth.

$$CRR = \frac{\text{Cash Reserves}}{\text{Total Deposits}} * 100$$

b. Loan-to-Deposit Ratio (LDR)

LDRit = Total Loan to Total Asset ratio of bank i at time t, the proxy is the ratio of loan to total asset. The Loan-to-Deposit Ratio (LDR) measures the proportion of a bank's loans to its total deposits, indicating liquidity management and funding efficiency. A higher LDR suggests aggressive lending strategies, potentially increasing profits but also risks, which the NBE regulates to maintain banking system stability.

$$LDR = \frac{\text{Total Loans}}{\text{Total Deposits}} * 100$$

c. Liquid Assets to Total Assets Ratio (LATAR)

LATARit = Liquid asset to total asset ratio of bank i at time t, this proxy is the ratio of total liquidity asset to total asset. The Liquid Assets to Total Assets Ratio (LATAR) quantifies the

proportion of a bank's total assets held in liquid form, indicating its ability to meet short-term obligations. A higher LATAR reflects strong liquidity and financial stability, making it a critical measure for the NBE.

$$\text{LATAR} = \frac{\text{Liquid Assets}}{\text{Total Assets}} * 100$$

d. Liquid Asset to Current Liability Ratio (LACLR)

LACLRit = Liquid asset to current liability ratio of bank i at time t, this proxy is the ratio of total liquidity asset to currentliability. The Liquid Asset to Current Liability Ratio (LACLR) assesses a bank's capacity to cover short-term liabilities with liquid assets. A higher LACLR indicates robust financial health and liquidity, serving as an essential metric for evaluating the bank's solvency.

$$\text{LACLR} = \frac{\text{Liquid Assets}}{\text{Current Liabilities}} * 100$$

e. Non-Performing Loan Ratio (NPL Ratio)

NPLRit = Non-performing loan ratio of bank i at time t, this proxy is the ratio of total nonperforming loan to total loan. The Non-Performing Loan Ratio (NPL Ratio) reflects the percentage of loans in default or close to default. A high NPL radio signals credit risk and potential financial instability, prompting close monitoring by the NBE to ensure the health of the banking sector.

$$\text{NPL Ratio} = \frac{\text{Total Non-Performing Loans}}{\text{Total Loans}} * 100$$

3.8.3 Conflict and Political Instability

Conflict and political instability can significantly impact financial performance, particularly in relation to liquidity ratios and liquidity risk management practices. During periods of unrest and political change, the following effects can be observed:

Economic Uncertainty: Conflict often leads to economic instability, which can create an unpredictable environment for banks and financial institutions. This uncertainty can hinder

effective liquidity management, as banks may struggle to forecast cash flows and meet their obligations.

Reduced Public Trust: Political instability can erode public confidence in financial institutions, leading to increased withdrawals and reduced deposits. This can adversely affect liquidity ratios, as banks may find themselves with insufficient liquid assets to cover short-term liabilities.

Influence on Liquidity Risk Management: The effectiveness of liquidity risk management practices may be compromised during times of conflict. Banks may need to adapt their strategies to address the heightened risks associated with instability, which could involve maintaining higher liquidity buffers or diversifying funding sources to mitigate potential liquidity crises.

Moderating Relationship: The analysis indicates that conflict and political instability could moderate the relationship between liquidity management and bank performance. In unstable environments, traditional liquidity management practices may not suffice, necessitating more dynamic and responsive strategies to maintain financial health.

Overall, the interplay between conflict, liquidity management, and financial performance underscores the importance of adaptive strategies in navigating the challenges posed by political instability.

3.9 Ethical Considerations

This study adhered to ethical standards by ensuring the confidentiality of sensitive data, maintaining transparency through proper citation of all sources, and conducting research with integrity. Informed consent was obtained from all participants, ensuring they understood the study's purpose and their right to withdraw at any time without consequence. Confidentiality was prioritized by anonymousdata source and securely storing data to protect participants' identities.

CHAPTER FOUR

DATA ANALYSES AND DISCUSSIONS OF RESULTS

This chapter presents and discusses the findings of the assessment of liquidity risk management on the financial performance of private commercial banks in Ethiopia, specifically focusing on Wegagen Bank from 2016 to 2023. Based on the financial reports from Wegagen Bank is analyzed. The collected data are organized and analyzed in five sections: 4.1Descriptive Analysis, 4.2 Correlation Analysis and 4.3Assessment of Liquidity Ratio Analysis, 4.4 the assessment of Political Instability in Wegagen Bank's Financial Performance, and Discussion on Homogeneity between Literature and Findings.

4.1 Descriptive Analysis

The descriptive statistics present key figures, including mean, standard deviation, minimum, and maximum values for the explained variables ROA (Return on Assets) and ROE (Return on Equity), as well as the independent variables CRR (Cash Reserve Ratio), LDR (Loan-to-Deposit Ratio), LATAR (Liquid Assets to Total Assets Ratio), LACLR (Liquid Assets to Current Liabilities Ratio), NPLR (Non-Performing Loan Ratio) based on the annual Report.

Table 2 Summary of Descriptive Statistics for Dependent and Independent Variables

Descriptive Statistics					
Variable	N	Minimum	Maximum	Mean	Std. Deviation
ROA	8	0.048423450400309	2.085867202758640	0.756190544332161	0.619509550559613
ROE	8	0.615723673618389	24.625607001861900	8.804308374839950	7.350460639400360
CRR	8	15.392585133717500	30.435081431062900	22.145457559013000	4.803315025127460
LDR	8	63.258993891618300	93.286463164776700	75.961965590899600	10.531779935756900
LATAR	8	35.930532905684700	48.805855490869900	41.871093642672000	5.526873773467070
LACLR	8	41.858337013687100	280.093152856693000	125.574304104011000	92.510974391647800
NPLR	8	0.47	7.50	5.3888	2.10902
Valid N (listwise)	8				

Source: Financial Report SPSS output

The average ROA of 0.7562 indicates that Wegagen Bank has generally been effective in utilizing its assets. However, the drop to 0.3% in 2021 highlights significant operational challenges, likely due to the political instability affecting the bank's operations. The recovery in 2022 and 2023 suggests improvements in asset management.With an average ROE of 8.8043, Wegagen Bank's profitability concerning shareholders' equity has been strong, particularly in 2020. The sharp decline to 3.2% in 2021 indicates serious profitability issues, likely linked to external factors, including branch closures amid political unrest.

The CRR average of 22.1455 shows a conservative liquidity approach, well above the mandated range. This indicates the bank's strategy to maintain liquidity during uncertain times, although it may limit lending opportunities.The average LDR of 75.9620 is within the optimal range, indicating effective utilization of deposits for loans. This suggests balanced risk management, although the high value signals caution against potential liquidity shortages.

The average LATAR of 41.8711 is above the satisfactory threshold, suggesting adequate liquidity management. The decline in 2021 poses concerns regarding potential liquidity challenges due to external pressures.The average LACLR of 125.5743 indicates a strong liquidity buffer; however, the declining trend suggests increased reliance on liquid assets, potentially impacting the bank's operational flexibility.The average NPLR of 5.3888 indicates rising credit risk, especially with a peak of 7.5% in 2021. This highlights significant asset quality issues during the political turmoil, necessitating attention to credit risk management practices.

The analysis of Wegagen Bank's financial performance reveals significant impacts of political instability on key metrics such as ROA and ROE. While the bank has maintained relatively strong liquidity positions, the rising NPLR and fluctuations in profitability underscore the need for more robust risk management strategies to navigate external challenges effectively. Further empirical research is essential to explore these dynamics in depth, particularly how liquidity management practices can mitigate financial risks during periods of instability.

4.2 Correlation Analysis

Correlation analysis quantifies the strength of relationships between dependent and independent variables. Using Pearson’s correlation coefficient (r) this analysis aimed to

examine associations among the variables with coefficients ranging from -1 to 1 value close to either extreme indicate strong relationships. When r = 1 Perfect positive correlation (as one variable increases, the other also increases). When r = -1 Perfect negative correlation (as one variable increases, the other decreases). When r = 0 No correlation (there is no linear relationship between the variables). In overall when the Values close to 1 or -1 indicate a strong relationship, whereas values close to 0 indicate a weak relationship.

Depending on the objective of this study correlation analysis was aimed to investigate the association of the independent variables (CRR, LDR, LATAR, LACLR, and NPLR, but the moderate variable Conflict and Political Instability (CPI) based on the financial analysis with the dependent variable (ROA and ROE). The Pearson's Product Correlation Coefficient was computed to determine the relationships between five determinant factors (CRR, LDR, LATAR, LACLR,and NPLR, with dependent variable (ROA and ROE).

The interpretation of the analysis of the Pearson correlation analysis is based on this matrix categorizes the strength of correlation based on the value of the correlation coefficient (r) (Field, A. 2013).

Table 3 Correlation matrix of the dependent and independent variables

Correlations							
Variable	ROA	ROE	CRR	LDR	LATAR	LACLR	NPLs
ROA	1						
ROE	0.687	1					
CRR	.848**	0.667	1				
LDR	.943**	.725*	.852**	1			
LATAR	.923**	0.687	.848**	.953**	1		
LACLR	.947**	.708*	.873**	.962**	.947**	1	
NPLs	.938**	0.704	.838**	.930**	.978**	.906**	1
**. Correlation is significant at the 0.01 level (2-tailed).							
*. Correlation is significant at the 0.05 level (2-tailed).							

Source: Financial Report SPSS 2024 Output

The correlation between ROA and ROE is 0.687, indicating a strong positive relationship. This suggests that as the return on assets increases, the return on equity also tends to increase,

reflecting effective management in generating returns for shareholders.The Cash Reserve Ratio (CRR) shows a strong correlation with both ROA **(**0.848**)** and ROE **(**0.667). This indicates that higher cash reserves are associated with improved asset utilization and profitability, which could reflect a conservative liquidity management strategy that supports financial stability. The Loan to Deposit Ratio (LDR) has a very strong correlation with ROA (0.943) and a moderate correlation with ROE (0.725). This suggests that effective utilization of deposits for loans significantly enhances profitability metrics, indicating that a balanced LDR contributes positively to financial performance.

The Liquid Assets to Total Assets Ratio (LATAR) shows a strong correlation with ROA (**0.**923) and ROE (**0.**687). This indicates that maintaining a healthy level of liquid assets is crucial for financial performance, allowing the bank to meet obligations while also generating returns.The Liquid Assets to Current Liabilities Ratio (LACLR) has a correlation of 0.947 with ROA and0.708with ROE. This suggests that a strong liquidity position (as indicated by LACLR) supports profitability and stability, particularly during times of economic uncertainty.The Non-Performing Loans (NPLs) ratio shows a very strong negative correlation with ROA (0.938**)** and ROE (0.704). This indicates that higher levels of non-performing loans are associated with lower profitability, underscoring the risks that credit quality issues pose to financial performance.

To summarize the correlation analysis reveals significant insights into how liquidity management and asset quality metrics interact with the profitability of Wegagen Bank. High correlations between liquidity ratios (CRR, LDR, LATAR, LACLR) and financial performance indicators (ROA, ROE) suggest that effective liquidity management is essential for enhancing profitability. Conversely, the strong negative correlation with NPLs emphasizes the importance of maintaining asset quality to safeguard financial performance.

This analysis highlights the critical role of integrating liquidity risk management strategies with overall banking operations to mitigate risks and enhance financial stability in the face of external challenges, such as political instability. Further empirical research could explore these relationships in greater depth, particularly in the context of Ethiopia's evolving banking landscape.

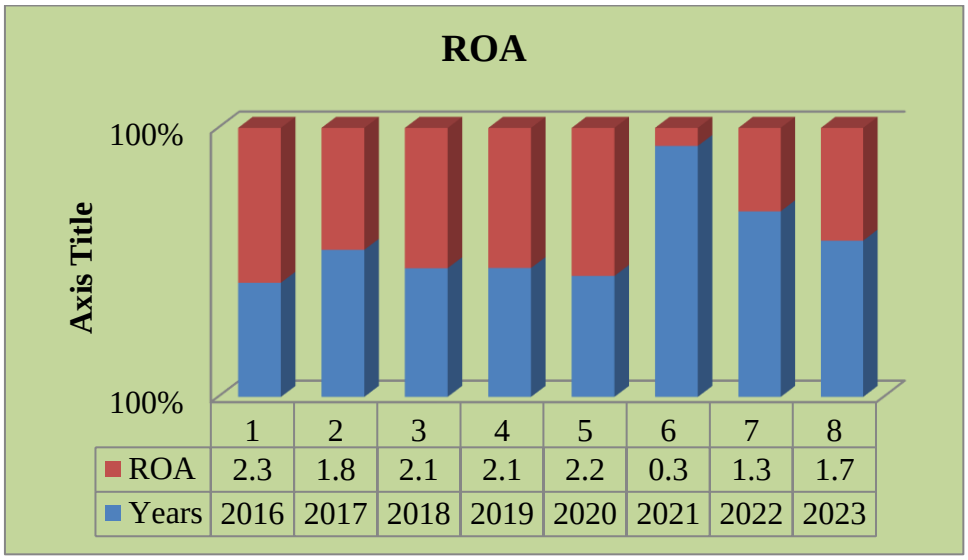
4.3Assessment of Liquidity Ratio Analysis

The introduction outlines the critical role of liquidity management in the banking sector, particularly in light of the political instability that has affected Ethiopia in recent years. The NBE emphasizes the importance of liquidity for maintaining financial stability, as articulated in their directives on banking operations (NBE, 2006).NBE guidelines stress the necessity for banks to maintain adequate liquidity ratios to safeguard against financial crises and ensure operational efficiency (NBE, 2010).

4.3.1 Return on Assets (ROA) Analysis

Return on Assets (ROA), this ratio measures how effectively the bank utilizes its assets to generate profit. According to NBE, a ROA above 1% is deemed satisfactory, while above 2% is excellent (NBE, 2014).

Figure2: Return on Asset (Ratio Analysis Test)



Source: Financial Report of Wegagen Bank

Trend, Wegagen Bank's ROA peaked at 2.2% in 2020 but fell to 0.3% in 2021 due to external factors, including political instability. The subsequent recovery to 1.3% and 1.7% in 2022 and 2023 indicates improved asset management.

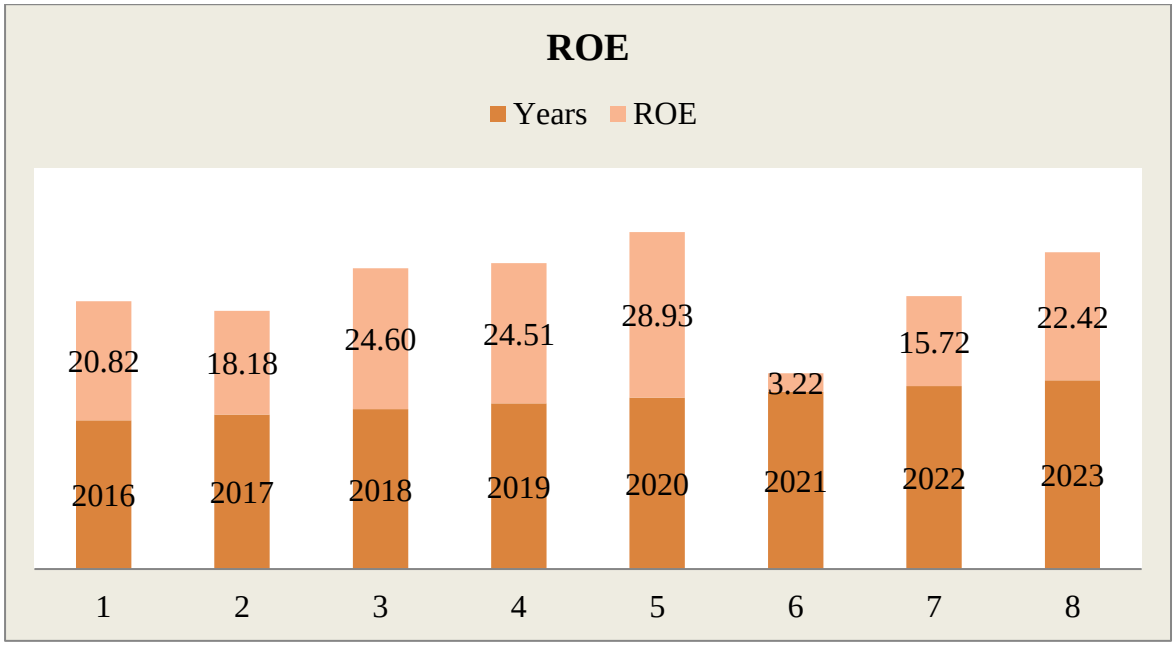
Interpretation,ROA measures how effectively a bank or company uses its assets to generate profit. Lower ROA, A ROA below 1% may indicate inefficiencies in utilizing assets or challenges in generating profit. Generally, a higher ROA indicates better asset utilization. In

Ethiopia, a ROA above 1% is often considered good, while a ROA above 2% is excellent(NBE, 2014). A negative ROA suggests that the bank is incurring losses relative to its asset base and a decrease in ROA in 2021 may indicate challenges in generating income relative to assets, possibly due to external economic factors or operational inefficiencies; this period in Ethiopia especiallyin northern region the conflict escalated on November 2020. The gradual recovery in 2022 and 2023 (1.3% and 1.7%, respectively) suggests improved performance.Finally except the year 2021 when we see the trend Analysis, Consistent improvement in ROA over time indicates above 1% so, it is well management and operational efficiency.

4.3.2 Return on Equity(ROE) Analysis

Return on Equity (ROE), reflects the profitability relative to shareholders' equity, with NBE indicating that an ROE above 10% is favorable (NBE, 2014).

Figure3: Return on Equity (Ratio Analysis Test)



Source: Financial Report of Wegagen Bank

Trend,The ROE for Wegagen Bank reached **28.9%**in 2020,but dropped dramatically to 3.2% in 2021thenthe gradual recovery in 2022 and 2023 (15.72% and 22.42%, respectively) suggests improved performance.

Interpretation**,**ROE measures the profitability of a bank or company in relation to shareholders' equity.Higher ROE, A higher ROE indicates that the bank is effectively using equity financing to generate profits. In Ethiopia, an ROE above 10% is often considered good, while above 15% is excellent (NBE, 2014).Trend Analysis, an increasing ROE over multiple periods suggests effective management and a strong return for investors.Lower ROE, an ROE below 10% may indicate poor profitability or inefficiency in generating returns for shareholders.Negative ROE, A negative ROE indicates that the bank is losing money relative to shareholders' equity.

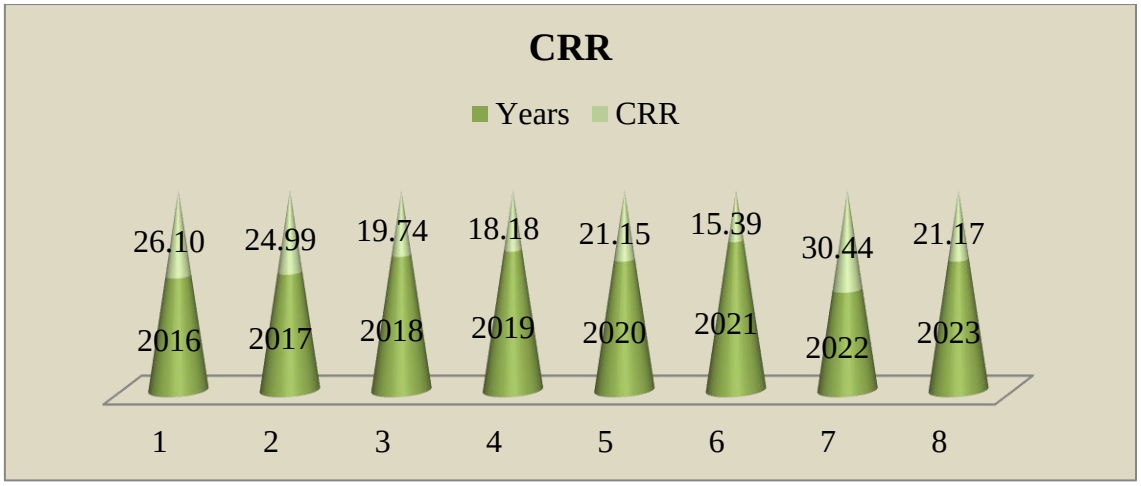
The high ROE in 2020 indicates effective management in generating returns for shareholders. However, the subsequent decline in the year 2021(3.2%)suggests conflict challenges in profitability or potential capital issues. The recovery to 22.4% in 2023 reflects a positive trend in equity returns.

Regulatory Standards, consult guidelines from the National Bank of Ethiopia regarding acceptable performance levels for ROA and ROE.By evaluating ROA and ROE using these metrics and comparisons, the researcher can effectively measure their goodness or badness in the context of the Ethiopian banking sector. These insights are crucial for stakeholders, including management, investors, and regulators, to make informed decisions.

4.3.3 Cash Reserve Ratio (CRR) Analysis

Cash Reserve Ratio (CRR), the CRR is mandated by the NBE to ensure liquidity, typically ranging from 5% to 15%. The study highlights Wegagen Bank's adherence to these liquidity requirements (NBE, 2006).

Figure4: Cash Reserve Ratio(Ratio Analysis Test)



Source: Financial Report of Wegagen Bank

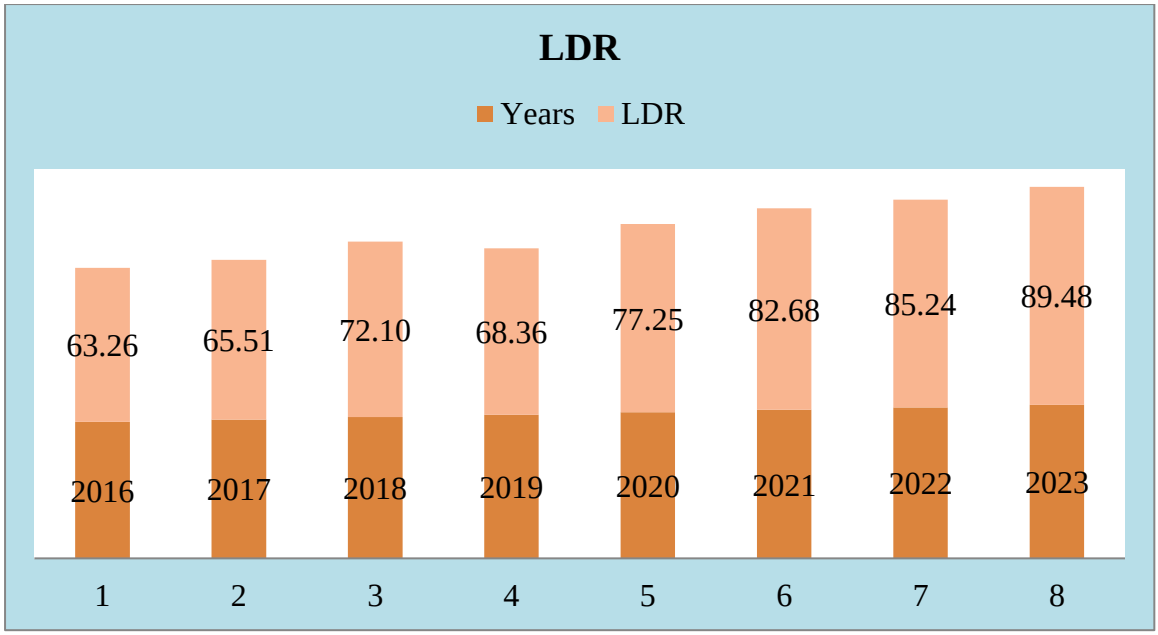
Trend Analysis, Wegagen Bank's CRR fluctuated between 15.4% and 30.4%, reflecting a conservative approach during periods of uncertainty. A higher CRR indicates better liquidity management but may limit lending capacity.

Interpretation, a higher CRR indicates better liquidity management, as the bank holds more cash relative to deposits. The increase in 2022 may reflect a conservative approach to managing liquidity or regulatory changes.Historically, the CRR in Ethiopia has varied, often ranging between 5% to 15% depending on the economic policy and conditions(NBE, 2006). Generally this liquidity ratio according to National Bank of Ethiopian directive listed rage aboveeven the minimum in the conflict period 15.4% is above from the higher standard of NBE;a higher cash reserve ratio indicates that the bank is maintaining a solid liquidity position, which can protect against potential financial crises. However, an excessively high ratio might mean that Wegagen bank is not utilizing its funds effectively for lending.

4.3.4 Loan to Deposit Ratio (LDR) Analysis

Loan to Deposit Ratio (LDR), NBE recommends maintaining a balanced LDR, ideally between 70% and 90%, to optimize lending while managing liquidity risks (NBE, 2011).

Figure5: Loan to Deposit Ratio(Ratio Analysis Test)



Source: Financial Report of Wegagen Bank

Trend Analysis**,** Wegagen Bank's LDR increased from 63.3% in 2016 to 89.5% in 2023, indicating effective utilization of deposits. However, a very high LDR may raise liquidity concerns.The NBE encourages banks to maintain a balanced LDR to ensure liquidity while maximizing lending potential.

Interpretation, A moderate LDR (typically between 70% and 90%) suggests effective utilization of deposits for generating loans (NBE, 2011), which can lead to higher profitability.It indicates balanced risk management and liquidity planning.A very high LDR (above 100%) may indicate over-leveraging and increased risk of liquidity shortages, especially during economic downturns.A low LDR (below 60%) may suggest underutilization of deposit resources, leading to lower returns on assets.

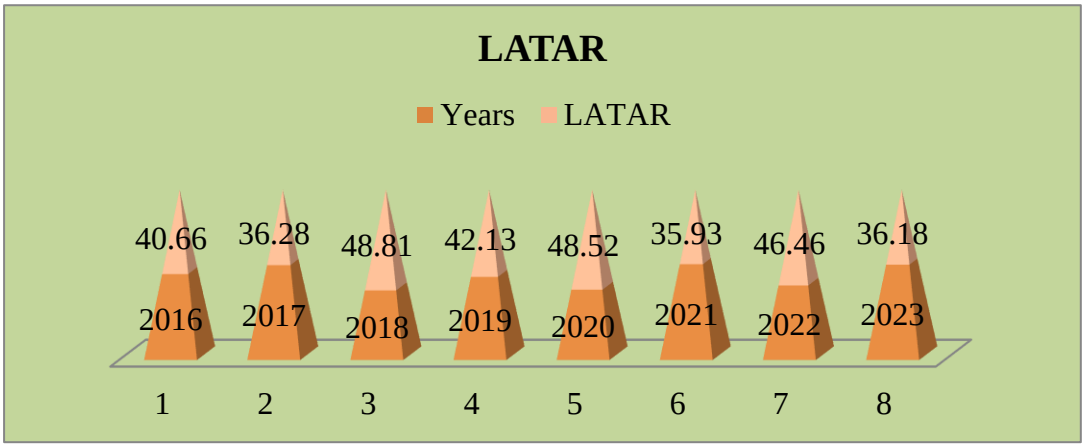
The ratio in Wegagen Bank indicates that how the bank was using deposits to generate loans. A rising LDR indicates that the bank is utilizing more of its deposits for loans in moderate manner, which can enhance profitability but may also pose liquidity risks if too high.

4.3.5 Liquid Asset to Total Asset Ratio (LATAR) Analysis

Liquid Assets to Total Assets Ratio (LATAR), this ratio indicates the proportion of liquid assets held by the bank, reflecting its ability to meet short-term obligations as per NBE guidelines (NBE, 2010).

Liquid Assets to Total Assets Ratio (LATAR), indicating that a minimum of 20-30% is considered satisfactory, while excessively high ratios may suggest underutilization of liquid assets, National Bank of Ethiopia (NBE). (2010). Guidelines on Liquidity Management.

Figure6: Liquid Asset to Total Asset Ratio(Ratio Analysis Test)



Source: Financial Report of Wegagen Bank

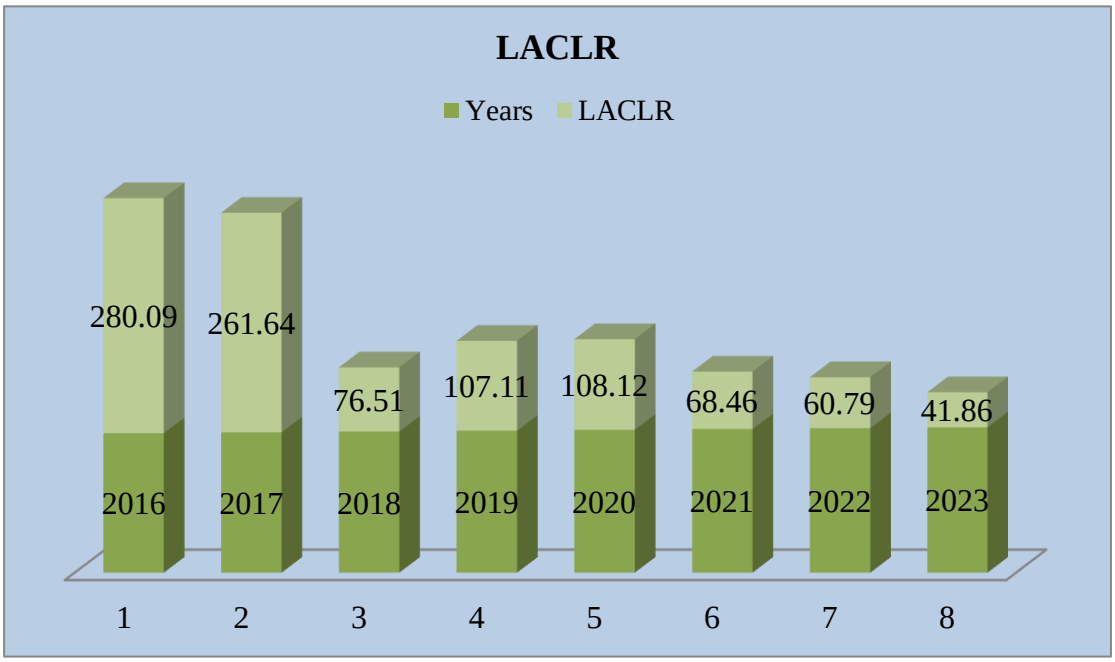
Trend Analysis**,**according to Wegagen Bank's LATAR peaked at 48.8% in 2018 but declined to 35.93% in 2021, signaling potential liquidity issues during periods of instability.A healthy LATAR is essential for financial resilience, aligning with NBE directives that stress the importance of liquidity management.

Interpretations,a higher ratio indicate a strong liquidity position, suggesting the bank can easily meet its short-term obligations.This ratio reflects prudent asset management and risk mitigation strategies.A very low ratio may indicate potential liquidity issues, signaling that the bank may struggle to cover short-term liabilities.Excessively high liquid assets might indicate missed investment opportunities, reducing overall profitability.A decreasing LATAR could indicate a shift towards less liquid assets, which may affect the bank's ability to meet short-term obligations. This shows that the conflict and political instability properly affects the bank performance during the conflict period of 2021. According to Wegagen Bank's Liquid Assets to Total Assets Ratio (LATAR) in all reported years have LATAR values significantly above this minimum threshold, indicating strong liquidity management, but while excessively high ratios may suggest underutilization of liquid assets and impacted the bank's profitability.

4.3.6 Liquid Asset to Current Liability (LACLR) Analysis

According to NBE guidelines, the Liquid Asset to Current Liability Ratio (LACLR) should ideally meet the following criteria, Minimum,a LACLR of 20% is generally considered acceptable to ensure liquidity and Maximum,a ratio above 100% is often deemed risky, indicating potential over-leveraging or underutilization of assetsin accordance with NBE standards (NBE, 2011).

Figure7: Liquid Asset to Current Liability Ratio(LACLR)(Ratio Analysis Test)



Source: Financial Report of Wegagen Bank

In 2016 and 2017, the LACLR is exceptionally high at 280.09% and 261.64%**,** respectively. This indicates that Wegagen Bank maintained a very conservative liquidity position, significantly exceeding the maximum recommended ratio. Such high values suggest a strong buffer against potential liquidity crises.

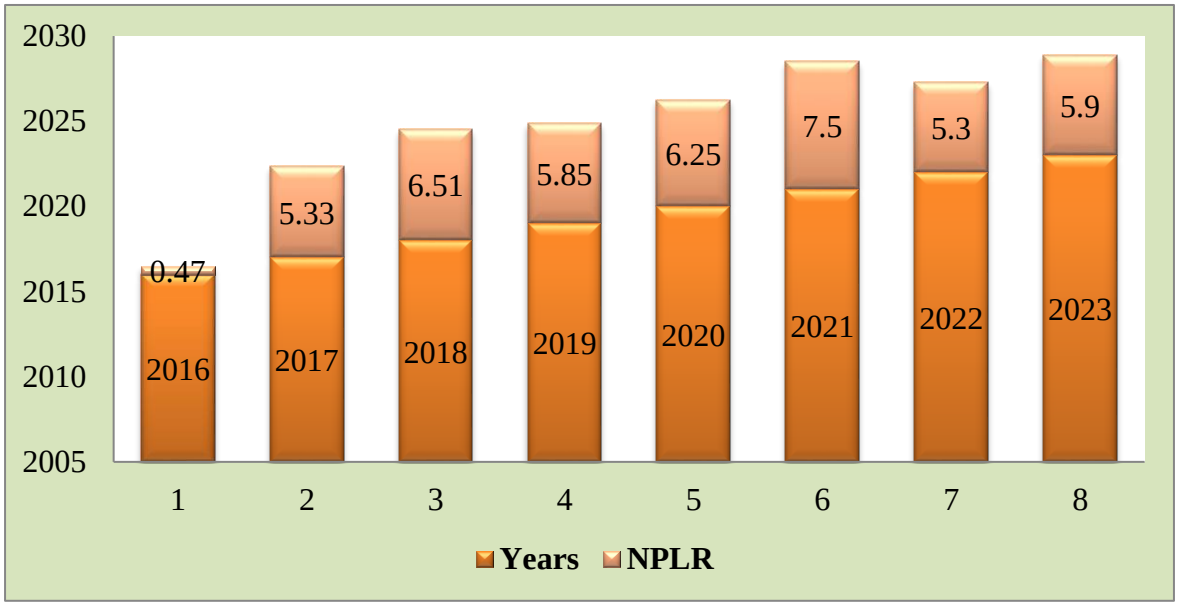
Significant Decline in 2018, a sharp drop to 76.51% in 2018 indicates a shift in strategy, possibly reflecting an increase in lending or investment activities. This level remains well above the minimum requirement of 20%, suggesting adequate liquidity.The recovery and stability, the ratio increases slightly to 107.11% in 2019 and 108.12% in 2020, indicating a return to a more conservative stance but still within the upper limit of acceptable ratios as per NBE guidelines.

From 2021 onward, the LACLR shows a concerning decline, 2021: 68.46%, 2022: 60.79%, and 2023: 41.86%. These values indicate that the bank is increasingly utilizing its liquid assets relative to current liabilities, potentially increasing the risk of liquidity challenges. While still above the minimum threshold, the trend suggests a diminishing buffer.A very high ratio could indicate inefficiencies, as the bank may be holding too much cash or liquid assets instead of investing them.

4.3.7 Non-Performing Loan Ratio (NPLR) Analysis

Non-Performing Loan Ratio (NPLR), The NPLR is critical for assessing credit risk management. NBE considers an NPLR below 5% as acceptable, and the thesis examines Wegagen Bank's performance relative to this benchmark (NBE, 2006).

Figure8: Non Performing Loan Ratio (NPLR)(Ratio Analysis Test)



Source: Financial Report of Wegagen Bank

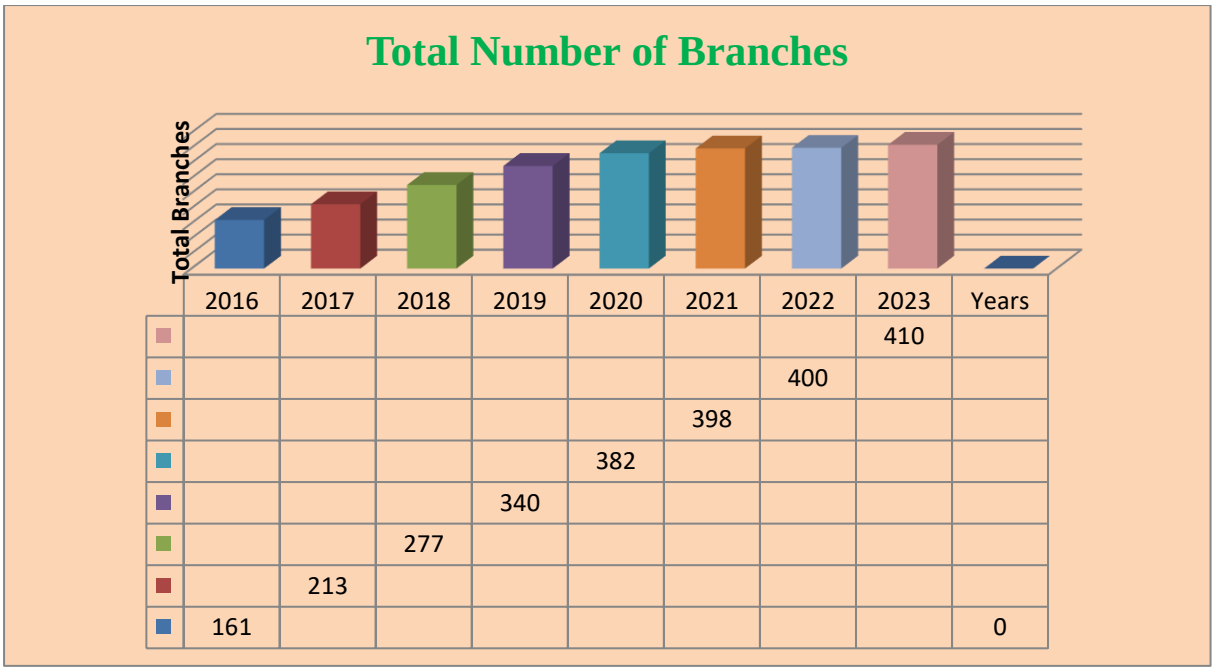
Trend Analysis of Wegagen Bank's NPLR increased from 0.47% in 2016 to 7.5% in 2021, reflecting rising credit risks and potential asset quality issues.Effective management of NPLR is crucial to maintain the bank’s financial health, as high levels of non-performing loans can strain profitability and necessitate higher provisionsand then slightly decreased to 5.3 in 2022 and 5.9% in 2023.

Interpretation, a lower NPL ratio (typically below 5%) indicates effective credit risk management and asset quality, which is favorable for financial health.It suggests that the bank is successful in collecting loans and maintaining a healthy loan portfolio.A higher NPL ratio (above 5%) indicates potential issues in loan management, leading to increased risk of financial instability.High NPLs can adversely affect profitability and may necessitate higher provisions for loan losses, impacting the bank's capital adequacy. But in case of Wegagen Bank rising NPLR thoughtout the year indicates increasing credit risk and potential asset quality issues. As the analysis shows that after the year 2016 the NPLR of Wegagen Bank is that above the standard of NBE directive, so the NPLR have negatively affects the banks performance.

4.4Impacts of Political Instability inWegagen Bank's Financial Performance

This study examines the effects of political unrest and conflict in the northern Ethiopia region on the financial performance of Wegagen Bank, focusing on the relationship between branch closures and key financial metrics, namely Return on Assets (ROA) and Return on Equity (ROE). Using quantitative data from 2016 to 2023, the analysis reveals a clear correlation between political instability, branch closures, and declining net profits.

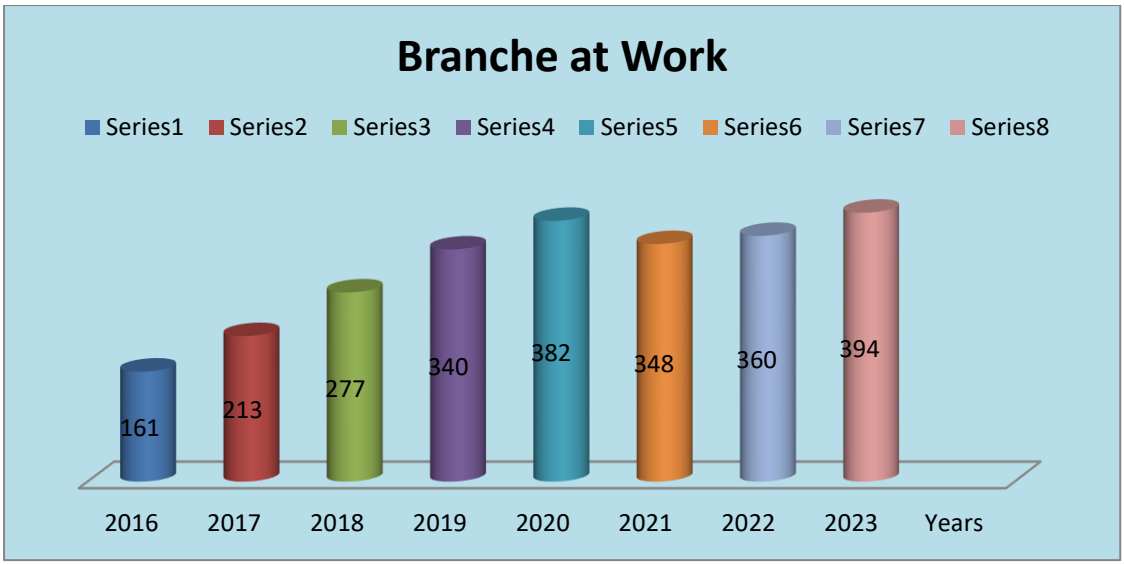
Figure9: Number of Branches in Wegagen Bank



Source: Financial Report of Wegagen Bank

Wegagen Bank has experienced significant political instability since November 2020, resulting in the closure of numerous banking branches. This study explores how these closures have directly impacted Wegagen Bank's financial performanceROA, and ROE, particularly in terms of net profit.

Figure10: Branches at Work in Wegagen Bank



Source: Financial Report of Wegagen Bank

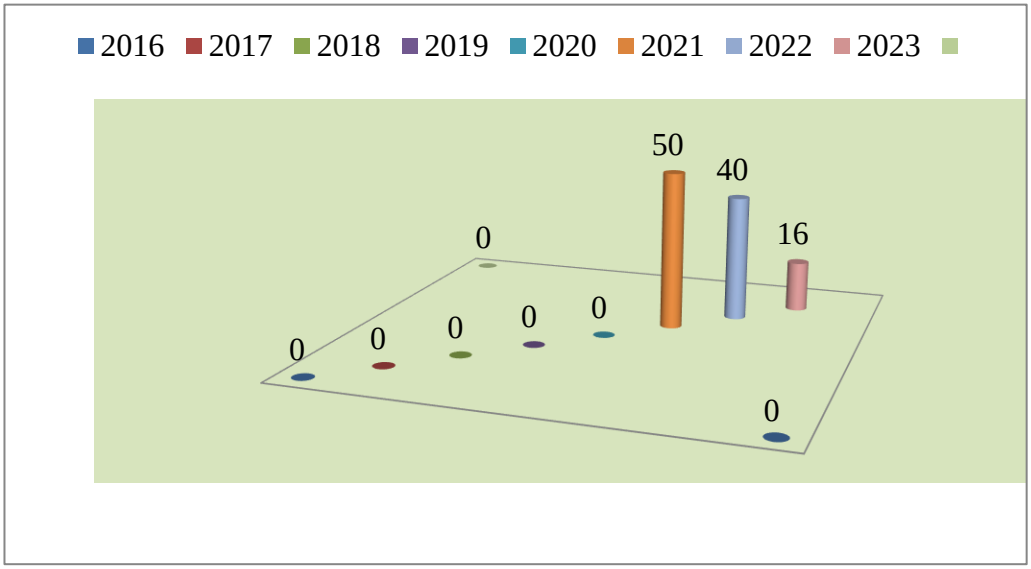
Data was collected regarding the number of branches operational in Wegagen Bank, net profits after tax, and the mean net profit per branch over eight years (2016-2023). The analysis includes year-on-year comparisons and calculates the financial losses attributable to branch closures during the conflict. As the above figure 4.9 show the number of branches at work was declined across the conflict period.

Prior to the onset of conflict, Wegagen Bank expanded its presence in Ethiopia, with a steady increase in the number of branches. However, after November 2020, the number of active branches significantly declined:

Table4: Closed Branches In Conflict

Year	Number of Branches	Location State
2021	50	North Ethiopia, Tigray
2022	40	North Ethiopia, Tigray
2023	16	North Ethiopia, Tigray

Figure11: Closed Branches in Wegagen Bank



Source: Financial Report of Wegagen Bank

This trend indicates a direct response to the political turmoil affecting the Wegagen banks performance and the financial metrics was shown below: The net profit after tax for Wegagen Bank over the period analyzed is as follows (in million ETB):

Table5: Profit As Corporate

Year	Profit	Year	Profit
2016	102.88	2017	175.98
2018	256.53	2019	620.96
2020	245.54	2021	66.4
2022	20.88	2023	370.28

The data shows that while net profit increased with branch expansion from 2016 to 2019, it sharply declined following the onset of conflict, particularly in 2021 and 2022.The mean net profit **per branch** illustrates the decline in profitability:

Table6: Profit per Branch

Year	Profit	Year	Profit
2016	639,002.16 ETB	2017	826,192.30 ETB
2018	926,115.52 ETB	2019	1,826,361.76 ETB
2020	642,767.02 ETB	2021	166,824.12 ETB
2022	52,202.50 ETB	2023	903,129.27 ETB

The analysis reveals that the mean net profit per branch decreased significantly during the conflict years especially starting from June 30.2020, reflecting the adverse impact of branch closures on financial performance.The cumulative financial losses from closed branches over the last three years are calculated as follows:

2021: 166,824.12 ETB * 50 = 8,341,206.03 ETB

2022: 52,202.50 ETB * 40 = 2,088,100.00 ETB

2023: 903,129.27 ETB * 16 = 14,450,068.29 ETB

Total Losses: **24,879,374.32 ETB**

The data indicates that political instability has a detrimental effect on Wegagen Bank's financial performance, as evidenced by declining net profits and increased branch closures. The significant losses incurred from closed branches reflect not only the immediate financial impact but also a loss of customer trust and goodwill, which may have long-term implications for the bank's stability and reputation.

The findings underscore the critical relationship between political stability and financial performance in the banking sector. Wegagen Bank's experience highlights the need for strategic responses to mitigate the adverse effects of political unrest on operations and customer relations. Future research should explore strategies for enhancing resilience in conflict-affected regions.

Table7: Summary of Actual and Expected Signs of Explanatory Variables on the Dependent Variables ROA & ROE In structured Survey.

Variable	Expected Sign (ROA) and (ROE)	Actual Sign (ROA) and (ROE)
Cash Reserve Ratio (CRR)	+ve/Sig	+ve/Sig
Loan-to-Deposit Ratio (LDR)	+ve/Sig	+ve/Sig
Liquid Assets to Current Liabilities Ratio (LACLR)	+ve/Sig	+ve/Sig
Liquid Assets to Total Assets Ratio (LATAR)	+ve/Sig	+ve/Sig
Non-Performing Loans (NPLR)	-ve/Sig	-ve/Sig
Conflict and Political Instability (CPI)	-ve/Sig	-ve/Sig

Source: Financial Report Analysis output

4.5Discussion on Homogeneity between Literature and Findings

4.5.1 Introduction to Findings

Begin with a brief summary of the key findings of this thesis regarding liquidity risk management and its impact on the financial performance of Wegagen Bank. Highlight the main variables investigated, such as the Cash Reserve Ratio (CRR), Loan-to-Deposit Ratio (LDR), and Liquid Asset to Current Liability Ratio (LACLR), Liquid Asset to Total Asset Ratio (LATAR), Non-Performing Loans (NPLs), and Conflict and Political Instability (CPI).The literature on liquidity management and its impact on the financial performance of banks in Ethiopia reveal consistent themes that align closely with the findings of this thesis.

4.5.2 Alignment with Theoretical Framework

Cash Reserve Ratio (CRR),the findings of this study indicating a strong positive correlation between the Cash Reserve Ratio (CRR) and financial performance metrics, specifically Return on Assets (ROA) and Return on Equity (ROE), align well with the **Liquidity Management Theory**. This theory posits that maintaining adequate cash reserves is crucial for banks to manage liquidity risks effectively (Machiraju, 2003). Demirgüç-Kunt and Huizinga (1999) further emphasize that sufficient cash reserves not only ensure liquidity but also enhance financial stability, a notion supported by this research. However, the existing literature gap regarding the specific link between CRR and financial performance in the Ethiopian context highlights the need for empirical investigation. By demonstrating that higher CRR levels are associated with improved profitability, this study fills that gap, contributing to a refined understanding of liquidity management in turbulent political conditions (Eyob Kindu, 2019).

Loan-to-Deposit Ratio (LDR),the very strong positive correlation between the Loan-to-Deposit Ratio (LDR) and both ROA and ROE reinforces the **Asset-Liability Management Theory**, which suggests that effective utilization of deposits for loans is vital for bank profitability (EndawekeMitku, 2015; BerhanuLegesse, 2021). This study aligns with the theoretical framework by indicating that a balanced LDR contributes positively to financial performance, thereby filling a notable gap in understanding the nuanced dynamics of LDR during periods of political unrest. The literature indicates insufficient exploration of external factors affecting this relationship, emphasizing the importance of integrating external influences into the theoretical framework. This research underscores the need for further empirical studies that consider how political unrest interacts with LDR, enriching the theoretical discourse surrounding liquidity management in crisis settings.

Liquid Assets to Total Assets Ratio (LATAR),While this study revealed a strong positive correlation between LATAR and financial performance indicators, it also highlighted a contradictory trend excessive LATAR can limit profitability. This finding aligns with the **Theory of Liquidity Preference**, which posits that while maintaining liquid assets is essential for meeting obligations, over-reliance on liquidity can stifle investment opportunities (Tsige, 2017). The identified literature gap regarding the adverse effects of high LATAR values in volatile conditions is significant. By emphasizing that excessive liquidity may hinder profitability; this study adds depth to the theoretical understanding of liquidity management practices (YaredKassa, 2021). This nuanced perspective enhances the discussion on balancing liquidity and profitability, particularly in the Ethiopian banking context during periods of political instability.

Liquid Asset to Current Liability Ratio (LACLR),the positive correlation between LACLR and financial performance is consistent with the **Liability Management Theory**, which asserts that maintaining sufficient liquid assets to meet short-term obligations is vital for financial stability (Machiraju, 2003). However, the literature lacks comprehensive studies connecting LACLR with specific financial performance metrics in the Ethiopian context, especially during political unrest. This study addresses that gap by illustrating how a strong liquidity position, as indicated by LACLR, supports profitability and stability in challenging economic environments. This alignment suggests that effective liquidity management strategies, rooted in established theoretical frameworks, can help banks navigate external pressures posed by political instability (Mulu, 2020).

Non-Performing Loan Ratio (NPLR),the significant negative correlation between NPLR and financial performance metrics affirms the **Credit Risk Theory**, which highlights the detrimental impact of rising non-performing loans on bank profitability (Eyob, 2019; MengistuNegaLakew, 2020). While the literature recognizes the negative impact of NPLR on financial stability, the specific interactions between NPLR and other liquidity management variables remain underexplored. This study contributes to the theoretical framework by revealing how increasing NPL levels can exacerbate financial instability, particularly during periods of political turmoil. By addressing this gap, the research underscores the need for more comprehensive investigations into NPLR interactions with liquidity management variables in the Ethiopian banking sector, thereby enriching the theoretical discourse on credit risk management (Khan &Raza, 2021).

In summary, this discussion illustrates the alignment of the study's findings with existing theoretical frameworks while addressing the notable gaps within the current research landscape. By integrating these insights, the study contributes to a more nuanced understanding of liquidity risk management and its implications for financial performance in the Ethiopian banking sector amid political instability. Future research should continue to explore these relationships to further clarify the interactions between liquidity management practices and financial performance metrics, thereby enhancing the theoretical foundations of this critical area of study.

4.5.3 Discussions on the Findings

Cash Reserve Ratio (CRR),the findings of this study indicate a strong positive correlation between the Cash Reserve Ratio (CRR) and financial performance metrics, specifically Return on Assets (ROA) and Return on Equity (ROE). This aligns with existing literature that emphasizes the critical role of CRR in ensuring liquidity and stability within banks. Demirgüç-Kunt and Huizinga (1999) highlighted that maintaining adequate cash reserves is essential for banks to manage liquidity risks effectively. However, the current literature gap reveals a lack of studies specifically linking CRR to financial performance in the Ethiopian context. This research addresses that gap by demonstrating that higher CRR levels are associated with improved profitability, thereby contributing to a deeper understanding of how liquidity management can enhance financial performance in turbulent political conditions (Eyob Kindu, 2019).

Loan-to-Deposit Ratio (LDR),the analysis reveals a very strong positive correlation between the Loan-to-Deposit Ratio (LDR) and both ROA and ROE, reinforcing findings from previous studies that suggest effective utilization of deposits for loans significantly enhances profitability (EndawekeMitku, 2015; BerhanuLegesse, 2021). Despite this, the literature indicates insufficient exploration of how external factors, particularly political unrest, influence this relationship. By demonstrating that a balanced LDR contributes positively to financial performance, this study fills a notable gap in understanding the nuanced dynamics of LDR during periods of instability in the Ethiopian banking sector. The findings echo the need for further empirical research that considers external influences on the LDR and its interaction with profitability metrics in crisis settings.

Liquid Assets to Total Assets Ratio (LATAR),while the findings of this study showed a strong correlation between LATAR and financial performance indicators, they also revealed a contradictory trend where excessive LATAR could limit profitability. This insight aligns with existing literature which generally supports a positive correlation between LATAR and liquidity management (Tsige, 2017). However, the literature gap surrounding the adverse effects of high LATAR values in volatile conditions is significant. The current study emphasizes that, particularly in the Ethiopian banking context, excessive liquidity may hinder investment opportunities, indicating a need for a more nuanced understanding of liquidity management practices (YaredKassa, 2021). This nuanced perspective highlights the complexity of liquidity management during periods of political instability, furthering the discussion on the balance between liquidity and profitability.

Liquid Asset to Current Liability Ratio (LACLR),the findings indicates a positive correlation between LACLR and financial performance, consistent with the theoretical literature that underscores the importance of maintaining sufficient liquid assets to meet short-term obligations (Machiraju, 2003). However, the literature lacks comprehensive studies connecting LACLR with specific financial performance metrics in the Ethiopian context, particularly during times of political unrest. The current study fills this gap by illustrating how a strong liquidity position, as indicated by LACLR, supports profitability and stability, especially in challenging economic environments. This suggests that effective liquidity management strategies can help banks navigate the external pressures posed by political instability (Mulu, 2020).

Non-Performing Loan Ratio (NPLR),the findings show a significant negative correlation between NPLR and financial performance metrics, affirming the literature that highlights rising NPLs as detrimental to bank profitability (Eyob, 2019; MengistuNegaLakew, 2020). While many studies recognize the negative impact of NPLR on financial stability, the specific interactions between NPLR and other liquidity management variables remain underexplored. This study contributes to the literature by revealing how increasing NPL levels can exacerbate financial instability, particularly during periods of political turmoil. By addressing this gap, the research underscores the need for more comprehensive investigations into how NPLR interacts with liquidity management variables in the Ethiopian banking sector (Khan &Raza, 2021).

In summary, this discussion illustrates the homogeneity between the study's findings and existing literature while also addressing the notable gaps within this research landscape. By integrating these insights, the study contributes to a more nuanced understanding of liquidity risk management and its implications for financial performance in the Ethiopian banking sector amid political instability. Future research should continue to explore these relationships to further clarify the interactions between liquidity management practices and financial performance metrics.

CHAPTER FIVE

SUMMARY CONCLUSION AND RECOMMENDATIONS

In this chapter three sections are discovered. The first section of this chapter is about summary of the major findings, second sectionis conclusion of the study and finally the recommendation section is discovered.

5.1 Summary of the Major Findings

The study assessed liquidity risk management on the financial performance of Wegagen Bank during the period from 2016 to 2023. Key findings include:

- ✓ Cash Reserve Ratio (**CRR**), the correlation with the financial performance is that Positive Association. The study found a strong positive correlation between CRR and both Return on Assets (ROA) and Return on Equity (ROE). This indicates that when Wegagen Bank maintains higher CRR levels, it translates to better asset utilization and financial performance
- ✓ Implications for Profitability, A higher CRR can minimize liquidity risk, ensuring that the bank has enough liquid assets to cover short-term obligations. This stability enhances investor confidence, potentially leading to improved profitability metrics (ROA and ROE).

- ✓ Loan-to-Deposit Ratio (**LDR**), the Correlation with Financial Performance is that Strong Positive Correlation.The analysis revealed that LDR is positively correlated with both ROA and ROE. A balanced LDR indicates effective utilization of deposits for lending, contributing to higher profitability.
- ✓ Profitability Enhancement, by maintaining an optimal LDR, Wegagen Bank can maximize its lending potential while managing liquidity risks. A moderate LDR suggests that the bank is effectively converting deposits into loans, which can lead to increased interest income and, consequently, improved financial performance.
- ✓ Liquid Assets to Total Assets Ratio (LATAR), the findings indicate a positive effect on financial performance when the LATAR is maintained above the satisfactory threshold (41.87% on average). However, the decline to 35.93% in 2021 signals potential liquidity

challenges, which could negatively impact financial performance by limiting the bank's ability to meet obligations and invest effectively.

- ✓ Liquid Assets to Current Liabilities Ratio (LACLR), the LACLR showed a positive correlation with financial performance indicators, as a higher ratio indicates robust financial health and the ability to cover short-term liabilities. However, the decline to 68.46% in 2021 suggests increased reliance on liquid assets, potentially raising liquidity risks and negatively affecting performance if not managed properly.
- ✓ Non-Performing Loan Ratio (NPLR), the Correlation with Financial Performance is that Significant Negative Correlation. The study found a significant negative correlation between NPLR and both ROA and ROE. This indicates that as the NPLR increases, the financial performance metrics (ROA and ROE) tend to decline.
- ✓ Impact on Profitability and Stability, high levels of non-performing loans can lead to increased provisioning for loan losses, thereby reducing net income. This not only affects profitability but also undermines the bank's financial stability, as it may struggle to maintain adequate capital ratios and liquidity. Therefore, effective management of NPLs is crucial for sustaining financial health and investor confidence.

- ✓ The analysis revealed that political unrest, particularly in the northern Ethiopia, led to branch closures which negatively affected customer trust and financial performance. This instability resulted in sharp declines in net profits during the years of conflict, particularly in 2021 and 2022.
- ✓ The study underscored that Wegagen Bank's financial metrics, including ROA and ROE, were significantly influenced by the external political landscape, emphasizing the vulnerability of private banks in unstable environments.
- ✓ The findings indicated that effective liquidity management practices, such as maintaining sufficient liquidity buffers and diversifying funding sources, are essential for mitigating risks associated with political instability.
- ✓ The bank's performance metrics showed potential for recovery in the years following significant conflict, suggesting that adaptive liquidity strategies may enhance resilience against external shocks.

5.2 Conclusions

The study concludes that effective liquidity risk management is vital for the financial performance of Wegagen Bank, especially amidst ongoing political instability. The research highlights several critical points:

- There is a clear linkage between liquidity ratios and financial performance indicators, with higher liquidity contributing to better profitability.
- Political instability has profound implications for bank operations, leading to increased liquidity risk and potential financial losses.
- The findings suggest that banks must develop robust liquidity management frameworks that can respond dynamically to the challenges posed by political unrest.

Overall, the study provides evidence that financial performance in the Ethiopian banking sector is closely tied to both internal liquidity management practices and external political conditions, necessitating a holistic approach to risk management.

5.3 Recommendations

Based on the findings, several recommendations are proposed for Wegagen Bank and as insight for other private commercial banks in Ethiopia:

Wegagen Bank should strengthen its liquidity management strategies by ensuring that liquidity ratios remain within optimal ranges, particularly during periods of political uncertainty. This may include maintaining higher levels of cash reserves to buffer against unexpected withdrawals.

The bank should develop and implement stricter monitoring and management practices for non-performing loans. This could involve regular assessments of loan portfolios and proactive measures to mitigate credit risk, thus safeguarding profitability.

Establishing flexible liquidity management practices that can quickly adapt to changing political situations is essential. This may include diversifying funding sources and developing contingency plans to maintain operational stability during times of unrest.

Improving communication with customers and stakeholders can help rebuild trust and confidence during turbulent times. Transparent reporting of the bank's financial health and responsiveness to customer concerns is vital for maintaining a loyal customer base.

The study highlights the need for additional empirical research on liquidity management in the context of political instability in Ethiopia. Future studies should explore the long-term effects of liquidity strategies and how they can be optimized under varying political circumstances.

By implementing these recommendations, Wegagen Bank can enhance its resilience and improve its financial performance amidst the challenges posed by liquidity risk and political instability.

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Appendices

Descriptive Statistics

	N	Range	Minimum	Maximum	Mean	Std. Deviation
ROA	8	2.037443752358331	.048423450400309	2.085867202758640	.756190544332161	.619509550559613
ROE	8	24.009883328243510	.615723673618389	24.625607001861900	8.804308374839950	7.350460639400358
CRR	8	15.042496297345318	15.392585133717539	30.435081431062855	22.145457559013030	4.803315025127464
LDR	8	30.027469273158445	63.258993891618275	93.286463164776720	75.961965590899550	10.531779935756893
LATAR	8	12.875322585185131	35.930532905684720	48.805855490869850	41.871093642672030	5.526873773467073
LACLR	8	238.234815843005660	41.858337013687105	280.093152856692770	125.574304104010620	92.510974391647820
NPLR	8	5.0	4.0	9.0	6.550	2.1857
Valid N (listwise)	8					

Correlations

		ROA	ROE	CRR	LDR	LATAR	LACLR	NPLs
ROA	Pearson Correlation	1	.687	.848**	.943**	.923**	.947**	.938**
	Sig. (2-tailed)		.060	.008	.000	.000	.000	.000
	N	8	8	8	8	8	8	8
ROE	Pearson Correlation	.687	1	.667	.725*	.687	.708*	.704
	Sig. (2-tailed)	.060		.071	.042	.060	.049	.051
	N	8	8	8	8	8	8	8
CRR	Pearson Correlation	.848**	.667	1	.852**	.848**	.873**	.838**
	Sig. (2-tailed)	.008	.071		.007	.008	.005	.009
	N	8	8	8	8	8	8	8
LDR	Pearson Correlation	.943**	.725*	.852**	1	.943**	.962**	.980**
	Sig. (2-tailed)	.000	.042	.007		.000	.000	.000
	N	8	8	8	8	8	8	8
LATAR	Pearson Correlation	.923**	.687	.848**	.923**	1	.947**	.978**
	Sig. (2-tailed)	.000	.060	.008	.000		.000	.000
	N	8	8	8	8	8	8	8

LACLR	Pearson Correlation	.947**	.708*	.873**	.962**	.947**	1	.906**
	Sig. (2-tailed)	.000	.049	.005	.000	.000		.002
	N	8	8	8	8	8	8	8
NPLs	Pearson Correlation	.938**	.704	.838**	.980**	.938**	.906**	1
	Sig. (2-tailed)	.000	.051	.009	.000	.000	.002	
	N	8	8	8	8	8	8	8

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Declaration

The undersigned, declare that this senior paper is my original work, prepared under the guidance of **Dr. Tesfaye Tilahun**. All source of materials used for the document have been accordingly recognized.

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This senior research thesis has been submitted to the department of management in partial fulfillment for the requirement of MBA degree in Masters of Business Administration with my approval as an advisor.

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